D.H.Baldwin Company
1975
Annual Report



A balanced financial services company engaged in banking, savings and loan and insurance activities, and the manufacture and sale of musical instruments.



LEGEND:

- Banking
- Savings & Loan
- Insurance
- Musical Instruments
- General Offices: Cincinnati, Ohio

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Annual Meeting

The annual meeting of shareholders of D. H. Baldwin Company will be held Monday April 26, 1976 at 10 A.M. at the Corbett Room, Music Hall, 1243 Elm Street, Cincinnati, Ohio. Shareholders of record March 19, 1976, are entitled to vote at this annual meeting.

S.E.C. Form 10-K

Copies of the Company's annual report on Form 10-K filed with the Securities and Exchange Commission, including the financial statements and schedules, is available to shareholders without charge by written request addressed to the Secretary of the Company.

About the Company

D. H. Baldwin is a balanced financial services company engaged in banking, savings and loan services and insurance, and the manufacture and sale of musical instruments. It is different from most other companies offering financial services. It is designed so that each service complements the other.

Banking

Baldwin, as a growing regional bank holding company, now has twelve banks in Colorado. The largest and lead bank is Central Bank of Denver with $334,844,000 in deposits. The Central Bank of Denver is complemented by the Central Bank of North Denver and the Central Bank of Aurora, both located within 25 minutes of downtown Denver.

Central Bank of Colorado Springs and Central Bank of Academy Boulevard serve the Colorado Springs area; and the Central Bank of Greeley serves the area along the Front Range of the Rockies lying north of Denver.

The Baldwin group of First National Banks serves the Western Slope with locations in Grand Junction, Glenwood Springs, and Aspen. The most recent addition to the Baldwin banks is the newly established First National Bank in Craig opened in September, 1975, in northwestern Colorado, the major coal producing district. The total Baldwin group of banks constitutes the fourth largest group in the Colorado community.

Savings and Loan

Empire Savings, Building and Loan Association of Denver, with deposits of $329,767,000 at December 31, 1975 is the fourth largest savings and loan association in Colorado. Its principal office is in downtown Denver, and it has seventeen branches throughout the state.

Insurance

National Farmers Union Service Corporation is an insurance holding company which, through subsidiaries, sells life insurance in twenty-three states and casualty insurance in twenty-one states, principally to members of the Farmers Union. The principal markets are Colorado, Montana, North Dakota, South Dakota and Minnesota.

Other Financial Services

Baldwin Finance Company finances retail instrument sales for Baldwin Piano & Organ Company. The Baldwin Company operates a general leasing business and the C. C. Fletcher Mortgage Company services $36,295,000 of commercial mortgages.

Music

Baldwin is recognized as a leader in the manufacture and sale of musical instruments. This part of the Company was founded in 1862 and has expanded from a modest retail store to an internationally known supplier of quality musical instruments. In 1975 it had sales and other revenues of $77,266,000, the largest ever recorded.

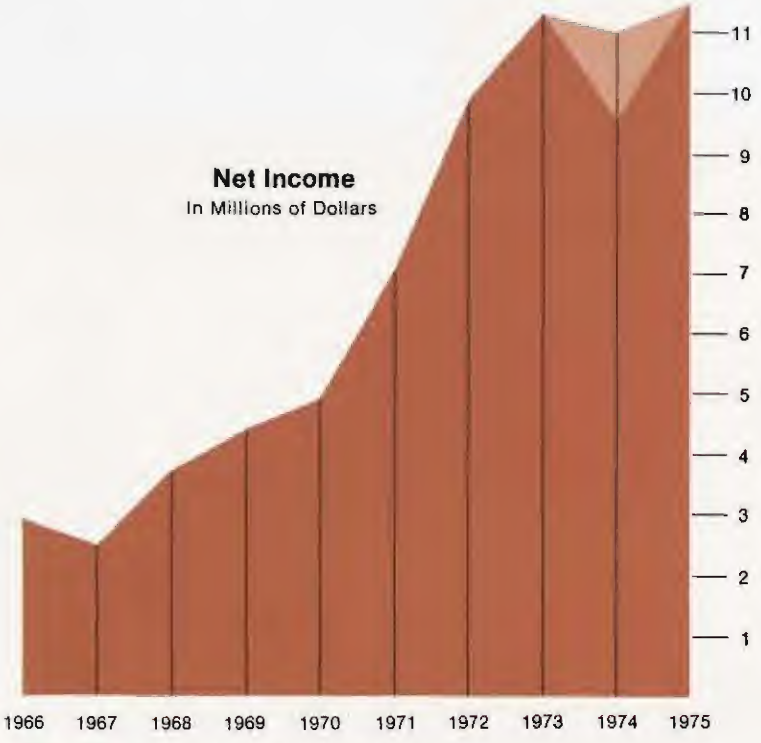
Baldwin

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Financial Highlights D. H. Baldwin Company and Subsidiaries

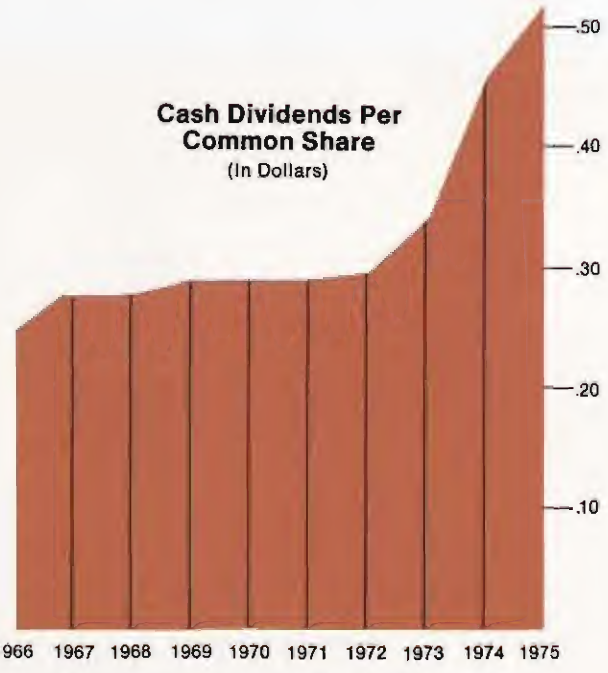
(in thousands of dollars except per share amounts)

	1975	1974	% Increase (Decrease)
Total combined assets	**$1,291,712**	1,198,482	7.8
Total combined revenues and sales	**$ 236,734**	210,616	12.4
Income:			
Before cumulative effect of a change in accounting principle	**$ 11,501**	9,639	19.3
Cumulative effect of a change in accounting principle	**$ —**	1,377	—
Net income	**$ 11,501**	11,016	4.4
Primary income per common share:			
Before cumulative effect of a change in accounting principle	**$ 1.75**	1.56	12.2
Cumulative effect of a change in accounting principle	**$ —**	.26	—
Net income	**$ 1.75**	1.82	(3.8)
Cash dividends per common share	**$ .52**	.45	15.6
Stockholders' equity	**$ 98,555**	94,467	4.3
Book value per common share	**$ 12.04**	11.33	6.3
Average number of common shares outstanding	**5,507,184**	5,315,909	3.6



Cumulative effect of a change in accounting principle

Ten year average compound growth rate: 16%



Ten year average compound growth rate: 9%



Lucien Wulsin
Chairman of the Board
D. H. Baldwin Company

Morley P. Thompson
President
D. H. Baldwin Company

Letter to Shareholders:

Your Company continued to grow in 1975 as follows:

Earnings

For the year 1975 your Company earned after taxes $11,501,000. This is the highest earnings ever reported. During the year 1974, your Company reported an income of $9,639,000, together with additional income of $1,377,000, resulting from the cumulative effect of a change in accounting principle, making a total of $11,016,000.

The average number of common shares outstanding increased from 5,315,909 to 5,507,184. Resulting net income per common share was $1.75, as compared with $1.56 in 1974 before the effect of a change in accounting principle and $1.82 after the cumulative effect of a change in accounting principle.

This increase in total consolidated earnings of your Company is attributable to the following increases over 1974: 1) income from banking and other related financial services of $813,000; 2) income from savings and loan services of $457,000; 3) income from musical instrument operations of $2,229,000; offset by a decrease in income from insurance services of $990,000. The comparisons are set forth in the summary by lines of business shown on the next page.

The summary of earnings in each quarter is set forth on Page 43 of this report. It is clear from this report that the Company has shown improved performance in the latter part of the year.

Revenues and Sales

The combined revenues and sales from all operations increased from $210,616,000 in 1974 to $236,734,000 in 1975, an increase of 12%. Of this total, banking and other related financial services revenues increased from $57,453,000 to $63,201,000; savings and loan revenues from $29,257,000 to $38,417,000; insurance revenues from $49,866,000 to $57,850,000 and music sales and revenues from $73,946,000 to $77,266,000.

Assets and Equity

Total combined assets increased from $1,198,482,000 to

CLEVELAND PUBLIC LIBRARY
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CORPORATION FILE

$1,291,712,000 and your equity in the Company from $94,467,000 to $98,555,000. This represents an increase in the book value of each common share from $11.33 to $12.04.

Lines of Business

In 1975 there were changes in the income derived from the four services your Company offers. Comparisons with 1974 are set forth as follows:

	(in thousands of dollars)			
	1975		1974	
Banking and other related financial services	**$ 6,456**	**40%**	$ 5,643	41%
Savings & loan services	**4,112**	**25**	3,655	26
Insurance services	**2,207**	**14**	3,197	23
Music & Other	**3,412**	**21**	1,276	10
Total income before holding company expenses	**16,187**	**100%**	13,771	100%
Less holding company expenses net of taxes	**4,686**		4,132	
Income before accounting change	**11,501**		9,639	
Cumulative effect of change in accounting principle	**–**		1,377	
Net income	**$11,501**		$11,016	

Management Comment

On Page 44 of this report will be found specific management comments on the results of last year's operations. They will not be duplicated here. However, it is significant to comment here on three significant aspects of the Company's overall results. The first has to do with bank loan losses. This subject has been debated in the public media, in the halls of Congress, and in regulatory offices. It is clear that if a bank is loaning where it should be loaning, losses will occur. The question is "how much?" Details of Baldwin bank losses are found on Page 7. The 1975 loan losses are larger than in 1974, fully covered by reserves, and well within limits of prudent bank management. The second is the remarkable increase in profitability in music. With a modest increase in sales, we tripled our profits. This came as the result of increased FunMachine sales, greater factory efficiency and better control of inventories. The third is the decline in insurance profitability. The cause lies in casualty insurance. In 1975 rates did not reflect sharply rising claims settlements. We are taking steps to rectify this imbalance. We do believe, however, that our 1975 results were better than industry comparables.



Timothy P. Hartman
Vice President & Controller
D. H. Baldwin Company

James E. Schwab
Treasurer
D. H. Baldwin Company

J. Leland Brewster II
Secretary
D. H. Baldwin Company

Baldwin Common Stock and Dividends

During 1975 the number of registered shareholders of common stock increased from 3,307 to 3,533. 30,258 shares of Class A preferred and 9,142 shares of Class C preferred were converted into 354,851 shares of common. As of December 31, 1975, the largest number of shareholders were concentrated in Ohio, Colorado and New York. During 1975, we earned $11,501,000, paid out $1,890,569 in preferred dividends and $2,899,133 in dividends to common shareholders, the equivalent of $.52 per common share. This means that we paid out to preferred shareholders

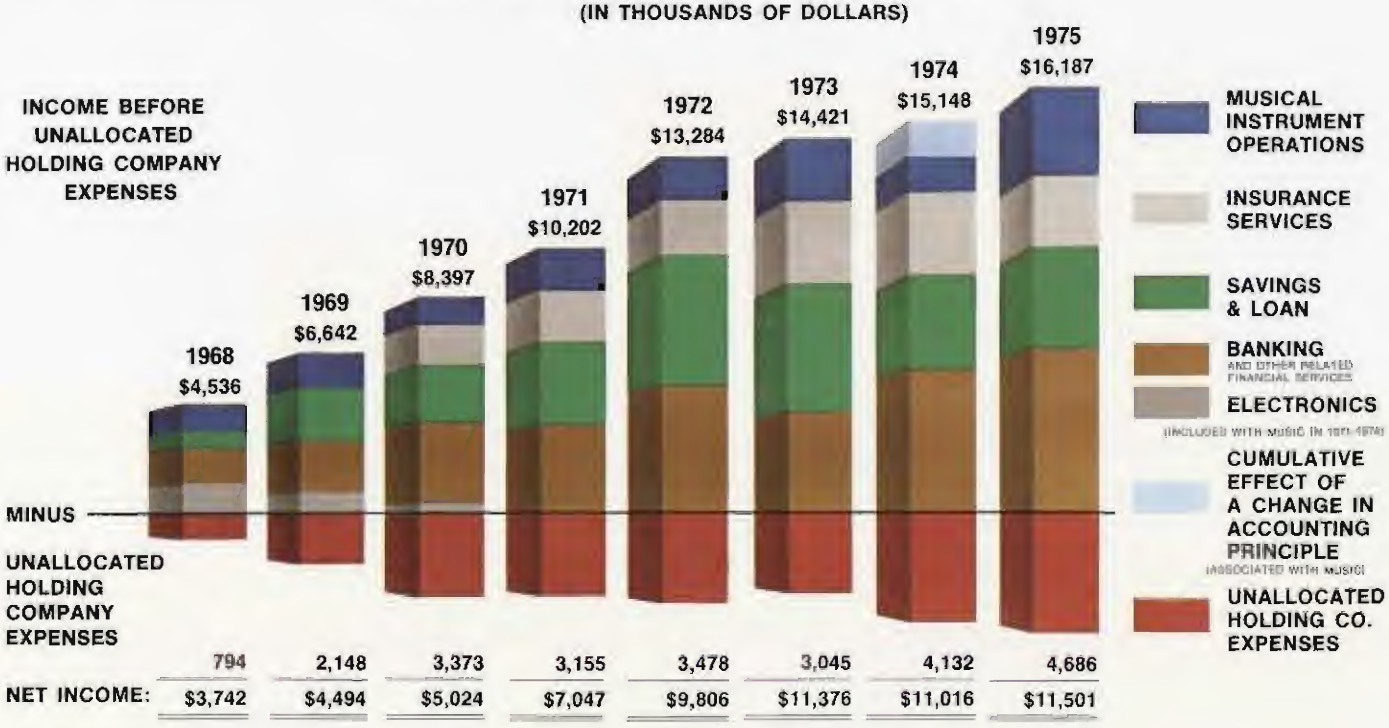
16.4% of our earnings and to common shareholders 25.2% of earnings and reinvested in our business $6,711,404, or $1.22 per share. Your management believes that this is an appropriate payout of earnings to shareholders and reinvestment of earnings. We feel this insures further growth of the business and that we can earn a suitable rate of return on this investment for the benefit of our shareholders. The return on common stockholder's equity has averaged 18.8% during the last five years.

People

The number of employees of the parent company and all subsidiaries decreased during the year from 4,800 to 4,400. We feel that the reduction in personnel has not impaired the quality of our services or production, that we have been able to serve our customers more effectively during the year past than we have previously and that the effect of the recession has made us look more critically at the quality of our people and the products or services we offer.

INCOME BY BUSINESS COMPONENTS

(IN THOUSANDS OF DOLLARS)



Related Matters:

The United Corporation

In April, 1975, we announced we were exploring a merger with United, a closed end investment company with which Baldwin has had financial and personal ties. These exploratory talks were terminated in September, 1975. The then relative market values of the companies made a proposed merger undesirable. By year end Baldwin and National Farmers Union Insurances had acquired 4.86% of United's common stock. In November, Morley P. Thompson, President of Baldwin, became a director and officer of United. In January, 1976, he was elected President of United. William M. Hickey, former President of United and a Baldwin director, became Chairman of the Board.

Refinancing

Your Company sold in March, 1976, a $15,000,000 issue of five and ten year Subordinated Capital Notes. The proceeds will be used by the parent company to pay the current maturities of long-term debt and to retire short-term debt.

Empire Application

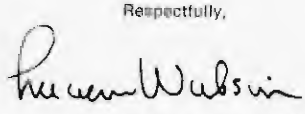
In January, 1976, your Company filed an application with the Federal Reserve Board to continue to hold beyond 1980 Empire Savings, Building and Loan Association as a permissible activity "closely related to banking". The granting of such an application would enhance the corporate design of Baldwin. Each of the four units operate together so as to produce a balanced growth for the shareholders. Savings and loan services are an inherent part of the Baldwin design to provide maximum consumer financial services for the community.

1976:

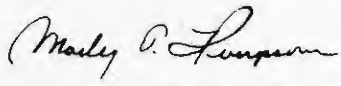
"Don't shoot the piano player; he didn't write the music." So wrote *Forbes* magazine to defend the bankers' performance for 1975 in an economic script they did not write. What will be the 1976 performance?

Baldwin has interest in the economy of the Rocky Mountain area and the rural development of the "high plains". These areas have survived the recession better than other regions. There are strong elements for balanced growth and development. Agriculture — Energy — Recreation — Technology. Also, the demand for the performance of music and for musical instruments continues strong. 1975 certainly showed our national collective and individual fallibility in understanding the causes of change in our economy. Baldwin's growth and profits are touched by this inadequate knowledge. We do not write our own music; yet 1976 recovery is on the road. The musical score for this year's economic scene is already written: Baldwin's performance of its music will be better than last year.

Respectfully,



Lucien Wulsin, Chairman



Morley P. Thompson, President

Banking and Savings and Loan



George B. McKinley
Chairman & President
First National Banks
In Aspen,
Craig, Glenwood
Springs, Grand
Junction and
Grand Junction – North

James E. Carpenter
President, Empire
Savings, Building
and Loan
Association

Max G. Brooks
Chairman and
Chief Executive
Officer, Central
Bank of Denver
Chairman, Central
Bank of North Denver,
Central Bank
of Aurora

The Colorado Economy

The Colorado economic climate is important to Baldwin's financial institutions. The Baldwin banks and Empire Savings are local in their orientation. They draw their deposits almost exclusively from local customers and lend their money to Colorado businesses primarily for Colorado projects. The state is also one of the principal markets for NFU insurance.

Manufacturing, agriculture, construction and tourism are regarded as the primary industries in Colorado even though government is the second largest employer. The federal government employs more people in Colorado than in any other area of the country except Washington, D.C.

During the first half of this decade, Colorado's population has grown at an average annual rate of 3.5% versus only 0.9% for the U.S. as a whole. The Colorado labor force has shown an average annual growth rate of 5.1% versus a national average of 1.4%, and Colorado's total personal income increase has averaged 12.5% per year versus 8.9% nationally.

Colorado experienced a decline in employment for the first time in ten years as the 1975 business recession proved to be more severe than originally anticipated. Nevertheless, late in 1975, the economy began picking up strength, and the recovery is expected to continue throughout 1976. Oil and gas, coal and mineral production should each show good advances during the year.

The level of construction activity declined for six straight quarters before bottoming out in the Spring of 1975. The value of total construction in Colorado for 1975 was $1.47 billion, down 3.3% from 1974. In 1976 the total is forecasted to rise slightly to $1.59 billion.

The 31,000 new jobs projected for 1976 will bring the unemployment rate in Colorado below the 1975 rate of 5.6% and markedly below the national level.

Proposed Banking Legislation

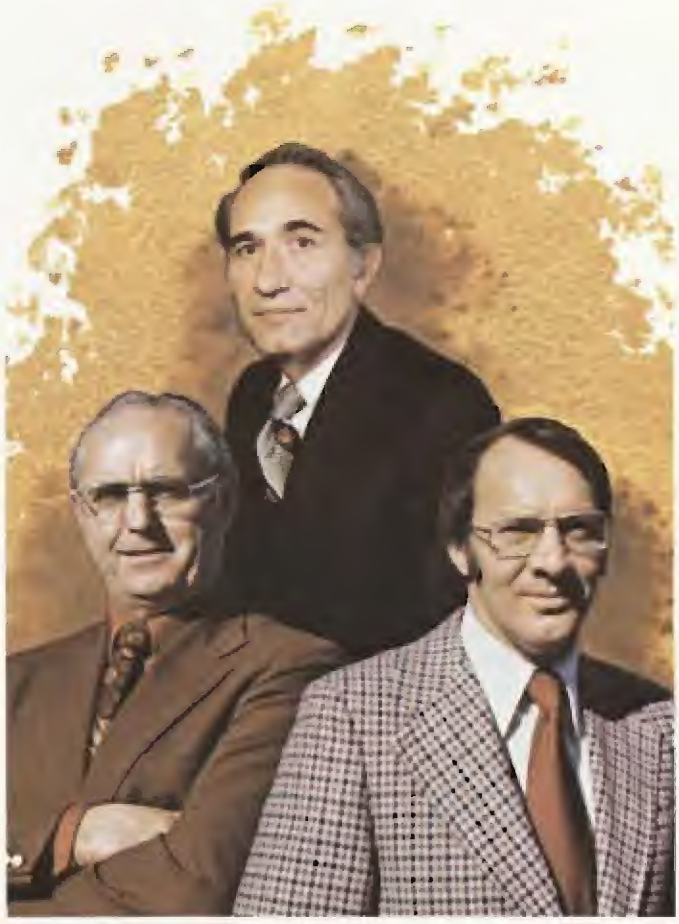
Presently branch banking is prohibited in the state by a law originally enacted in the late 1800's. However, bills have been introduced in both houses of the state legislature which would permit limited branch banking. The proposed legislation would also restrict bank holding growth through mergers and acquisitions and regulate electronic funds transfer systems. There is sharp disagreement among legislators and bankers on these measures. It is difficult to predict at this time what, if any, legislation will be enacted during the session. Your management is playing an active role in the development of this legislation and will keep you informed of changes as they occur.

Adoption of New Names

The names of six banks were changed during the last fifteen months in order to capitalize on the image and reputation of Central Bank in the Colorado market. The Central Bank & Trust Company became Central Bank of Denver; North Denver Bank, Central Bank of North Denver; Central Colorado Bank, Central Bank of Colorado Springs; Academy Boulevard Bank, Central Bank of Academy Boulevard; State Bank of Greeley, Central Bank of Greeley; Peoples Bank of Arapahoe County (acquired in January 1975), Central Bank of Aurora.

Income from Banking Services

Baldwin's income from banking services increased 13% to $6,320,000 in 1975. Loans were up 5% and deposits 3%, with increases coming in demand and consumer savings deposits and a significant decrease of $22,000,000 in the domestic time deposits over $100,000. The decrease in the use of the large time deposits was calculated to reduce the banks' exposure to the volatile swings in interest rates which we have seen in the past five years. These swings can be particularly troublesome to the Baldwin banks because a major portion of the loan portfolio is committed to fixed rate consumer installment loans. The return on the average stockholders' equity of the combined banking services was 11.2% last year, up from 10.9% in 1974. The return on average assets also increased to .9% from .8%.



Mads Anderson
President
Central Bank
of North Denver
Central Bank of Aurora

Donald D. Hoffman
President & Chief
Administrative Officer
Central Bank of
Denver

James Gunter
Executive Vice President
Central Bank
of Aurora

Bank Loan Losses

Total bank loans at year end 1975 were $450,384,000. Consumer loans, including credit card loans, make up 39% of the loan portfolio. Commercial and industrial loans and mortgage loans are the next largest categories at 34% and 16%, respectively. As your management reported to you late last year, there are no major problem loans anywhere in the banking group. Total loans to real estate investment trusts, for instance, were .1% of the loans outstanding at December 31, 1975. Loans on non-accrual were $2,763,000 or .61% of the loan portfolio at the same date. There is no way, of course, to predict



Wesley E. Strain
President
Central Bank of
Colorado Springs

William Perry
President
Central Bank
of Academy
Boulevard

Donald L. Farmer
President
Rocky Ford National
Bank

P. Dewayne Krause
President
Central Bank of Greeley

which of these non-accrual loans, if any, will actually have to be written off in subsequent periods.

Net loan losses in 1975 in banking services were $3,126,000 as compared with $1,753,000 in 1974. The losses net of recoveries occurred in the consumer loan sector — $2,158,000 — and in the commercial and industrial loan sector — $874,000. The provision for losses charged against banking services income increased to $3,061,000 from $1,727,000 in 1974. The allowance for loan losses stood at $4,333,000 at December 31, 1975 just slightly higher than the year earlier level and was equal to 1.07% of total average loans outstanding during 1975.

Investment Securities

Bank assets allocated to investment securities declined by $2,800,000 during the year. Bonds issued by state and political subdivisions were $55,100,000 at year-end or 8% of total banking assets with an average maturity of 8.1 years. Ownership of New York city and state obligations is negligible.

Denver Area Banks

With the addition of Central Bank of Aurora in January, 1975, Baldwin now has three banks operating in the Denver market. The two smaller banks, Central Bank of North Denver and Central Bank of Aurora, can call upon the resources and expertise of the lead bank, Central Bank of Denver for assistance in serving their customers. The Central Bank of Aurora expanded and remodeled its facilities last year and Central Bank of North Denver acquired its existing quarters and a tract of adjacent land in order to facilitate future expansion.

Central Bank of Denver's 1975 profits were approximately $3,000,000 about even with last year's. Operating income declined slightly more than operating expenses but securities gains added to the overall total net income. Total loans declined as decreases in mortgage and consumer loans were not offset by increases in commercial and industrial loans. Deposits declined $19,000,000, solely due to a planned reduction in the use of $100,000 and over time certificates of deposits. Consumer savings increased $18,000,000 during the year.

Central Bank of Denver installed three automated teller machines in 1975, two in the bank building and one in the adjoining drive-in facility. When coupled with the planned expansion of the BankAmericard and Chextra programs, and the introduction of the Entree card, these activities put Central Bank of Denver in a position to capitalize on the developments in electronic funds transfer systems.



James W. Mackley
Executive Vice-President
First National Bank — North in Grand Junction

R. L. Quimby
Executive Vice-President
First National Bank in Grand Junction

K. Kyle Revelle
Executive Vice-President
First National Bank in Craig

Ernest J. Gerbaz
Senior Vice-President
First National Bank of Glenwood Springs

Thomas S. Starodoj
Executive Vice-President
First National Bank in Aspen

Front Range and Eastern Plains Banks

Colorado Springs

The Central Bank of Colorado Springs and the Central Bank of Academy Boulevard are still operating in a somewhat depressed economy. There is a surplus of residential housing which will take probably another 12 months to clear; unemployment is a little higher than elsewhere in Colorado. Nevertheless, the two Baldwin banks registered increases in loans and deposits last year.

Central Bank of Colorado Springs began construction on its new banking headquarters which is scheduled for completion in mid-year 1976. The new facility will permit the bank to consolidate all of its operations in one building for the first time.

Greeley and Rocky Ford

Although located in different parts of the state, Rocky Ford National Bank and Central Bank of Greeley serve essentially agricultural communities. Both experienced loan and deposit increases during the year in spite of mixed results in crop yields and prices.

Mountain and Western Slope Banks

An already strong Western Colorado economy continued to strengthen during 1975. Agriculture again provided stability to this area and skiing and tourism reached new record levels. The national energy situation has made energy-related industries such as coal, oil shale, uranium, and electrical utility development the fastest growing segment of the Western Colorado economy.

The First National Banks in Aspen, Glenwood Springs, Grand Junction and North in Grand Junction combined for a 9.4% deposit growth over 1974. Profits in these four banks increased 8.2% over 1974. The First National Banks in Glenwood Springs and Grand Junction also completed new drive-in facilities to better serve their increasing customer base.

The latest addition to the Baldwin banking group is the First National Bank in Craig. Opened in September, 1975, the bank is situated at the center of an area whose employment in the coal industry could double in the next five years, with coal production increasing more than five times during the same period. By year end, the bank's deposits had grown to $1,363,000. This is Baldwin's first experience with a de novo bank activity. We are especially pleased with the progress to date.

Empire Savings

The year 1975 brought a record increase of $62,982,000 in deposits to Empire Savings and a record of $113,000,000 in loans closed. Total assets were $431,324,000 at year-end, up $57,878,000 for the year. These increases were achieved along with a 13% increase in earnings from $3,655,000 to $4,112,000. No net loan losses were experienced.

An Increasing Spread

The significant fact behind these figures is that the spread between average cost of funds and average yield on mortgages was substantially improved during the year. At the end of 1974, average cost of savings was 6.03% and average cost of borrowed funds was 8.26% for a weighted average cost of 6.59% for all funds. During 1975, the average cost of savings increased to 6.28%, due largely to a continued movement of deposits by savers into longer-term, higher-yield accounts. Cost of borrowings, however, declined to 7.80% because the large increase in savings deposits enabled Empire to repay $10 million in high-cost debt incurred in late 1974. Average cost of all funds by the end of 1975 had therefore declined to 6.54%, a drop of four basis points from one year earlier. On the other hand, average yield on mortgages increased steadily from 8.20% to 8.45%, widening the over all spread between cost and yield from 161 basis points to 191 basis points. Managing this spread properly is an important factor in the profit formula



One of Empire's newest branch offices, opened December 1975, near the Aurora Mall, Denver, Colorado.

for Empire Savings. Increasing this spread by 30 basis points in 1975 will contribute significantly to the profitability of Empire in 1976 and subsequent years.

Three New Branches

Administrative costs increased during the year largely due to continued inflation and to the building, staffing, and opening of three new full-service branch offices. The first of these new offices, the Aurora Mall Branch, is adjacent to the Aurora Mall Shopping Center, a new major regional center just east of Denver in the city of Aurora. It will give Empire a solid foothold in the fast-growing east and southeast sectors of the metropolitan area. The second office, the Southglenn Branch, is located at the main entrance to the Southglenn Shopping Center, another new regional center serving the south metropolitan area. The third office, opened just after year end, is located at Hampden Avenue and Tamarac Street in southeast Denver. It is squarely in the center of the most-rapidly expanding area of the city. During only their first six weeks of operation, these offices collectively took in over $3 million in savings funds and built loan commitment lists totalling $1.4 million. These results gave each of the new facilities a solid start toward profitability, which normally is achieved by a full-service branch at a balanced level of $5 million in savings and $5 million in loans.



North Woods Condominiums, Vail, Colorado, financed by Empire.

In addition, the size of the Bear Valley Branch was increased 40% by a remodelling of the existing facility. Located in the Bear Valley Shopping Center, this office has $38 million in savings deposits and serves the southwest metropolitan area. It has the highest activity of any of Empire's branch offices. The Bear Valley office is slated to receive the first of several Empire Automated Teller Machines during 1976. The machine will be placed in the entry wall of the building, providing twenty-four hour check-cashing, deposit, withdrawal, and payment services.

Future Plans

During 1976, Empire will put into operation a fully electronic on-line teller terminal and computer system servicing its 100,000 savings accounts and 13,000 loan customers. The system will greatly speed customer service and will enhance management's ability to obtain quick and reliable information. Under active consideration now are a number of smaller branch locations in the Denver metropolitan area and in the towns on the western slope of the Colorado Rocky Mountains.

Achievement of Empire's profit goals for 1976 will not come easily. The metropolitan Denver area and in fact, most of the front range area of Colorado, is still over-built to a significant degree. There are bright spots in single-family construction and selected commercial projects. The real estate depression of 1975 will continue with more difficulties and failures surfacing during 1976. For the longer term, however, the Colorado market for real estate oriented financial institutions remains bright and promising.

Financial Services:

Life and Casualty Insurance



Raymond F. Novak
President
National Farmers Union
Insurance Services

The National Farmers Union insurance companies do business in rural America with farmers, non-farm rural residents and the giant cooperatives that are so important to agriculture. Nearly 250,000 farm family members of the National Farmers Union and other rural residents are served by a network of 800 agents in 23 states throughout the agricultural heartland of the United States.

There are three companies in the National Farmers Union insurance group. Property and Casualty, the largest, had $42,912,000 in direct written premiums last year; Life Company had $550,000,000 insurance in force at year end and premiums of over $17,000,000 in 1975. Standard, a small special-risk auto company, contributed $1,671,000 in premiums. Because of a healthy farm economy fueled by a growing world demand for food, the companies have more than doubled their premium writings since 1970. Total insurance assets have grown from $50,000,000 to $107,000,000 over the same period.

Casualty Insurance

NFU property and casualty services' 1975 profits were down about $1,100,000 to $1,057,000 mainly because of heavy auto casualty losses. These losses are being countered by a nationwide re-underwriting program (which involves a thorough review of underwriting procedures and practices), and by rate increases. Rate

increases in automobile insurance lines averaged 19.3% in 1975. The increases will be continued in 1976 and extended to other lines written by the company.

Life Insurance

A bright exception to most of the life insurance industry in 1975, NFU's first year life premium sales grew 17.4% while the industry's growth was significantly impeded by the 1975 recession. Unfortunately, because of sky-rocketing medical and doctor costs, accident and health insurance profits were down, leaving the Life Company profit at $1,923,000, roughly comparable to the $1,971,000 earned in 1974.

The long-term growth and profit potential for the NFU companies is very exciting for at least two reasons. First, recent federal legislation now makes it feasible for a large segment of NFU's market to participate in IRA or Keogh retirement plans which are frequently funded by life insurance. In today's prosperous farm economy, these developments provide a strong source of continuing demand for permanent life insurance and annuity contracts.

Second, although the number of farms is declining, the average investment per farmstead, particularly in farm equipment, is rising rapidly. Serving this industry should mean higher property and casualty sales and, more importantly, an expanding market for estate planning services and life insurance for the Life Company.



Claims Dept. — NFU Headquarters, Denver, Colorado.

In farming, major land and machinery investment increases the need for thorough estate planning provided by NFU's life insurance company.

Crop hail insurance on standing crops, NFU Property & Casualty Co's. most profitable line in 1975.

Morgan County Electric Co-operative, Ft. Morgan, Colo. Insured under NFU's rural utilities insurance plan.

Musical Instrument Operations

Musical instrument sales in 1975 reached $77,266,000, an increase of 4.5% over 1974. For the second successive year, net income increased by over 30%, reaching $3,412,000 compared with $2,560,000 in 1974, and $1,972,000 in 1973. This was a record year for the musical instrument division in spite of the recession and the switch in 1974 to LIFO accounting.

The improved results in 1975 were brought about by the efforts of Baldwin personnel in all departments, and by our strong dealer organization, which is one of our greatest assets.

Keyboard sales and market share increased significantly, due primarily to the acceptance of our new easy to play FunMachine. Musical instrument sales in world markets continued to improve, led by sales in Canada which exceeded last year by over 25%.



R. S. Harrison
President
Baldwin Piano & Organ Co.

James M. E. Mixter
Vice President
Baldwin Piano & Organ Co.

Eugene Wulsin
President
The Baldwin Piano Company (Canada) Ltd.

Improved Efficiency

Greater efficiency was achieved at the manufacturing level. Better utilization of labor occurred in all plants. At our woodworking and finishing facility in Greenwood, Mississippi, not only did labor efficiency increase, but a major reduction in material waste took place.

Better Inventory Control

The cost of carrying inventories was reduced dramatically, partially because of lower interest rates, but principally because factory inventories were reduced by $8,500,000, while production levels remained virtually unchanged.

In 1975 the ratio of sales to finished goods inventory improved significantly and is now closer to the standards of other consumer products. Better stock turn of field inventories improves dealer profitability, and reduces the risk of obsolescence.

New Facilities

The additional warehouse and finishing facilities in Greenwood of 150,000 sq. ft. improved efficiency more than anticipated. In 1975, 100,000 sq. ft. of additional space in Fayetteville was completed. These additions, together with new and improved tooling and equipment — both woodworking and electronic — put the music division in an excellent position for future growth.

Increasing costs so prevalent in 1974 leveled in 1975 permitting us to maintain prices throughout the year. Costs are increasing and some price adjustment will be necessary in 1976, but because of increased efficiency we hope it will be minimal. We are below capacity in all of our manufacturing facilities, and greater efficiency is a realistic goal.

1976 Prospects

The prospects for 1976, though difficult to predict, are encouraging. In 1975 emphasis was placed on asset management, particularly inventory control, and quality improvement. In 1976 every effort will be made to maintain the stock turn and inventory goals achieved last year. Even greater emphasis will be

placed on improving the quality of our products, throughout the entire line.

Keyboard installment contracts serviced by our finance company increased by 10% to $30,100,000 at year end. The quality of the portfolio is excellent and continued to improve in spite of the recession. Lower interest rates helped make 1975 a profitable year, and the prospects for 1976 are for further improvement.

The current year will be a challenge for all of us. In addition to improvements at the manufacturing level, particularly quality, our success will depend on an aggressive sales effort and our ability to improve our market share throughout the country and the rest of the world.



Baldwin offers a wide variety of musical instruments from the top selling FunMachine, to world renowned Grand and Vertical Pianos.

D.H. BALDWIN COMPANY

Banking and Other Financial Services

Banks in Colorado

- Central Bank of Academy Boulevard
- Central Bank of Aurora
- Central Bank of Colorado Springs
- Central Bank of Denver
- Central Bank of Greeley
- Central Bank of North Denver
- First National Bank in Aspen
- First National Bank in Craig
- First National Bank of Glenwood Springs
- First National Bank in Grand Junction
- First National Bank-North in Grand Junction
- Rocky Ford National Bank

Other Financial Services

- Baldwin Finance Company
- The Baldwin Company
  - Baldwin Leasing Services
- C.C. Fletcher Mortgage Company
- Computer Congenerics Corporation of Colorado

Savings & Loan

- Main Office, Downtown Denver
- Arvada
- Aurora
- Bear Valley
- Broomfield
- Castle Rock
- Dillon
- Fort Collins
- Greeley
- Longmont
- Loveland
- Montbello
- Northglenn
- Southglenn
- Tamarac
- University Hills
- Westland Center
- Wheat Ridge

Insurance Services

- National Farmers Union Service Corporation
- National Farmers Union Life Insurance Co.
- National Farmers Union Property & Casualty Co.
- National Farmers Union Standard Insurance Co.
- National Farmers Union Exploration Corporation

Musical Instruments

Operations

- Baldwin Piano & Organ Company
- The Baldwin Piano Company (Canada) Limited
- Baldwin Export Corp.
- C. Bechstein Pianofortefabrik G.m.b.H.
- Fabricantes Tecnicos, S.A.

Manufacturing Plants

- Arkansas: Conway, DeQueen, Fayetteville
- Mississippi: Greenwood
- Ohio: Cincinnati
- Mexico: Juarez
- West Germany: West Berlin, Karlsruhe, Escheibronn
- Dealers or Company Owned Sales Outlets in all principal cities in the United States, and abroad

Officers

Lucien Wulsin
Chairman of the Board

Morley P. Thompson
President

R. S. Harrison
Vice President

Max G. Brooks
Vice President

James E. Carpenter
Vice President

James M. E. Mixter
Vice President

Eugene Wulsin
Vice President

Timothy P. Hartman
Vice President & Controller

James E. Schwab
Treasurer

J. Leland Brewster II
Secretary

Donald E. Waggoner
Assistant Secretary

Lenwood F. Maurer
Assistant Secretary

Joseph R. Lincoln
Assistant Secretary

Ira Dumont Gouge
Assistant Vice President

Directors

Gordon Adamson
Vice President
Baldwin Piano & Organ Company

Max G. Brooks
Chairman of the Board
Central Bank of Denver
Vice President
D. H. Baldwin Company

Fred Gretsch, Jr.
Chairman of the Executive Committee
The Lincoln Savings Bank
Brooklyn, New York

R. S. Harrison
Vice President
D. H. Baldwin Company
President
Baldwin Piano & Organ Co.

William M. Hickey
Chairman
The United Corporation
New York, New York

John F. Jordan
Technical Consultant
Retired, Former
Vice President

Lawrence H. Kyte
Partner, Law Firm of
Kyte, Conlan, Wulsin & Vogeler
Cincinnati, Ohio

William A. Mitchell
Retired Chairman of the Board
The Central Trust Company
Cincinnati, Ohio

James M. E. Mixter
Vice President
D. H. Baldwin Company
Vice President
Baldwin Piano & Organ Co.

Morley P. Thompson
President
D. H. Baldwin Company

Eugene Wulsin
Vice President
D. H. Baldwin Company
President
The Baldwin Piano Company
(Canada) Limited

Lucien Wulsin
Chairman of the Board
D. H. Baldwin Company

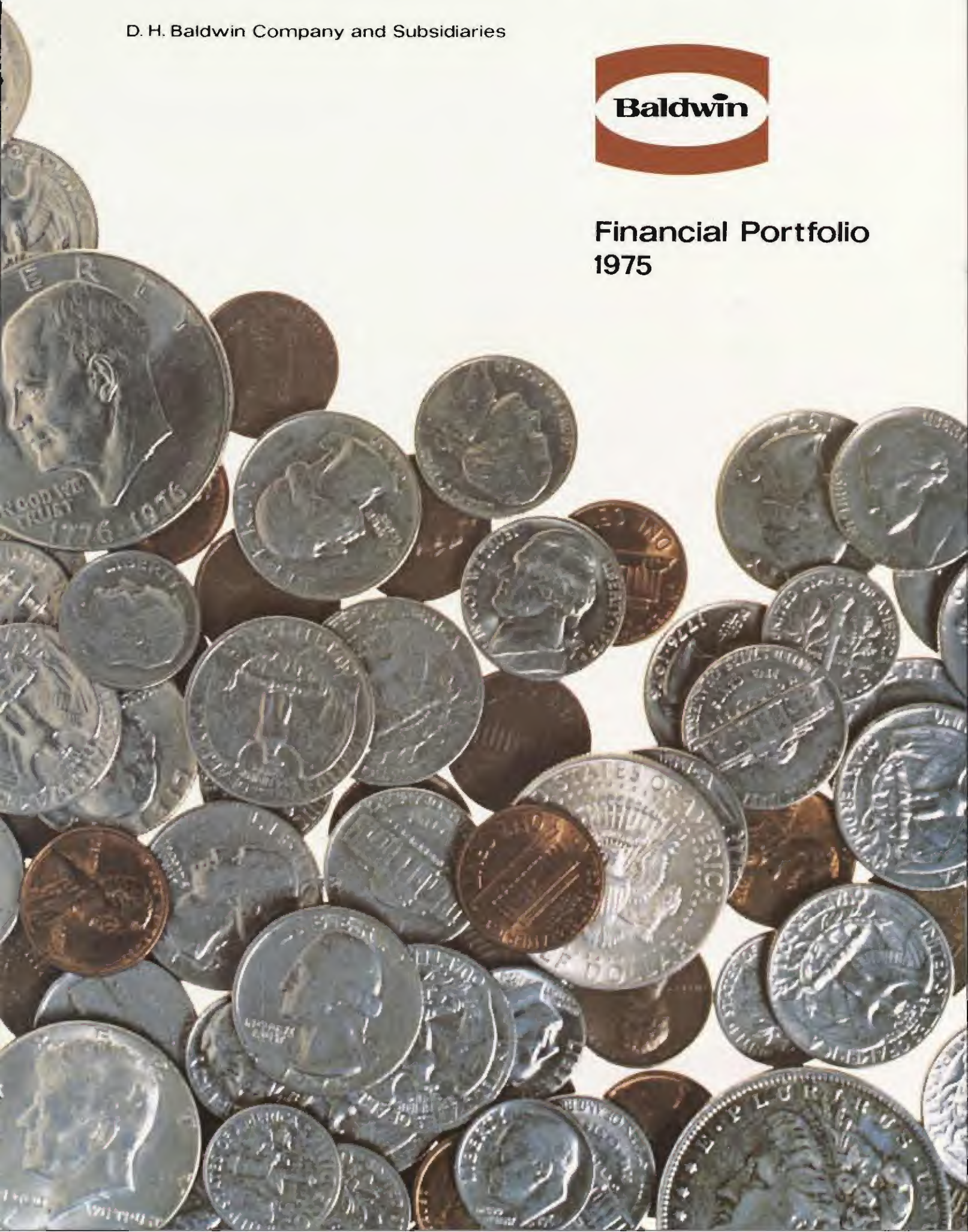
Robert E. Fanning
Director Emeritus

Philip Wyman
Director Emeritus

D. H. Baldwin Company and Subsidiaries

Baldwin

Financial Portfolio 1975



Financial Review

Year ended December 31, 1975

Development of Financial Resources

Over the past five years, D. H. Baldwin Company earnings have increased from $7,047,000 in 1971 to $11,501,000 in 1975, the best year in the history of the Company. Total combined assets have grown $605,301,000 over the same period to $1,291,712,000. Book value per common share was $12.04 at year-end up from $7.66 in 1971. The Company's Colorado financial subsidiaries now manage time, savings and demand deposits totalling $895,000,000, an increase of $77,000,000 during the year.

Stockholders' equity was $98,555,000 after a reduction of $2,656,420 to reflect the unrealized loss on the Company's marketable equity securities. This is a new accounting principle which was applied for the first time in 1975. The amount and nature of this adjustment depends on the change in the market value of the common and preferred stocks owned by the Company and its insurance subsidiaries. The adjustment is more fully discussed in footnote 1B.

Dividend Increases

The quarterly dividend paid to the common shareholder was increased twice during 1975. The first, a 2 cent increase, was paid in June, 1975. The second, an additional 3 cents, was paid in September and December, 1975. The annual dividend to the common shareholder is now 60 cents per share.

Debt Refinancing

During the year, the parent company placed $22,870,000 of long-term debt, approximately $12,900,000 of which was subordinated. This debt is described fully in footnote 5. It was marketed generally in the form of retail notes maturing in 5, 10 and 15 year intervals at interest rates ranging from 9% to 9¾%.

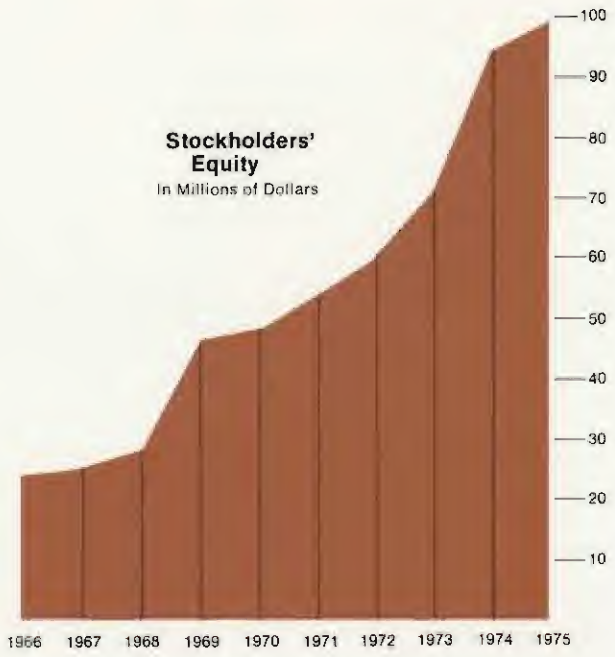
Reducing The Use of Short-Term Debt

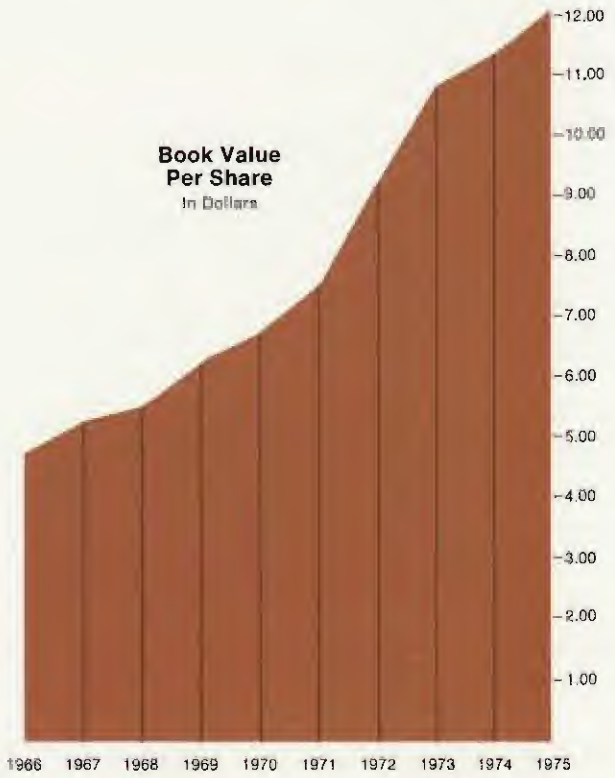
The issuance of the new debt raised the total debt in the parent company by $5,300,000 to $64,374,000. Short-term bank credit and commercial paper, however, were reduced by $13,100,000 to $2,930,000. Thus, the plan to refund all the short-term debt in the parent company which was begun in late 1974, was virtually complete at year-end 1975. When coupled with the dramatic improvement in the balance sheet of Baldwin Piano & Organ Company where the current ratio went from 1.74 to 1 to 7.5 to 1, this refunding means that only Baldwin Finance Company relies on short-term bank debt to finance its operations.

No Unmet Capital Needs

The Company invested $12,200,000 in its subsidiaries and affiliates during the year. These capital infusions were financed, in part, by the use of the new long-term debt and, in part, by recycling $7,032,000 of dividends received from these subsidiaries and affiliates. As a result of these infusions, the Company has no unmet capital needs in any of its companies at year end 1975.

In summary, your management believes that the solid 1975 earnings performance of the Baldwin companies, the refinancing of short-term debt, especially in the parent company, and the strong capital position of each of the companies all combine to produce a balanced, stable and flexible financial position for your Company.





D. H. Baldwin Company and Subsidiaries

Five Year Historical Review

(in thousands of dollars except per share amounts)

	1975	1974	1973	1972	1971
Banking services					
Average balances					
Net loans	$ **402,526**	396,644	249,645	205,886	170,936
Investment securities	$ **111,663**	115,239	60,422	49,135	45,499
Deposits	$ **565,180**	555,935	331,091	290,904	247,207
Capital at year-end	$ **64,714**	57,170	31,429	29,763	27,768
Banking offices	**12**	10	1	1	1
Savings and loan services					
At year-end					
Loans	$ **372,844**	329,040	297,708	262,833	214,031
Loans classified as scheduled items	**.4%**	.2%	.001%	.017%	.016%
Savings and time deposits	$ **329,767**	266,785	254,929	234,137	188,147
Federal Home Loan Bank borrowings	$ **51,364**	61,642	33,367	27,988	27,988
Home and branch office locations	**18**	15	15	13	13
Insurance services					
For the year					
Life — earned premiums on first-year business	$ **1,354**	1,122	1,017	754	691
Casualty — net premiums written	$ **36,900**	32,200	26,700	24,700	22,800
Casualty ratio of losses and expenses to earned premiums	**106.9%**	95.8%	93.5%	93.7%	95.1%
At year-end					
Life insurance in force	$ **550,014**	492,629	379,101	326,063	296,184
Life and casualty investments	$ **75,127**	71,652	64,915	56,556	51,282
Combined financial services					
Revenues	$ **159,468**	136,577	108,547	91,573	80,667
Assets	$**1,243,877**	1,150,616	876,436	807,631	658,393
Income[1]	$ **12,775**	12,496	12,494	12,445	9,007
Musical instrument operations					
Net sales and revenues	$ **77,266**	73,946	66,238	59,015	47,864
Assets	$ **47,835**	47,866	41,306	27,925	28,018
Income[1]	$ **3,412**	2,560	1,972	1,320	1,348
Electronic operations — equity increase (decrease)	$ **—**	93	(46)	(481)	(153)
All operations combined					
Total revenues and sales	$ **236,734**	210,616	174,739	150,107	128,378
Total assets	$**1,291,712**	1,198,482	917,742	835,556	686,411
Net income	$ **11,501**	11,016[2]	11,376	9,806	7,047
Net income per common share	$ **1.75**	1.82	2.00	1.72	1.20
Cash dividends per common share	$ **.52**	.45	.34	.29	.28
Annual earnings reinvested in the business	$ **6,711**	7,267	8,725	7,361	4,696
Stockholders' equity	$ **98,555**	94,467	70,169	61,394	53,283
Book value per common share	$ **12.04**	11.33	10.77	9.11	7.66
Average number of common shares outstanding	**5,507,184**	5,315,909	5,256,637	5,176,624	5,090,262
Market price of common share	$ **6-12**	5-14	11-21	11-21	7-14

[1]Before deduction of unallocated holding company interest and administrative expenses.

[2]Net income in 1974 includes the cumulative effect of a change in accounting principle. LIFO was also adopted in 1974 and as a result net income and primary income per share were reduced by $1,348,000 and $.26 respectively. These changes are related to the musical instrument operations and are explained in note 2 to the financial statements.

D. H. Baldwin Company and Consolidated Subsidiaries

Consolidated Statements of Income

Years Ended December 31, 1975 and 1974

	1975	1974
Banking and other related financial services:		
Interest and fees on loans	**$48,752,257**	$46,286,744
Income on investments	**7,232,662**	6,308,744
Other revenues, including security gains	**7,215,588**	4,858,135
	63,200,507	57,453,623
Expenses:		
Interest	**23,693,266**	26,352,489
Provision for loan losses	**3,242,802**	2,219,304
Operating expenses	**26,736,830**	20,814,512
Federal and state income taxes (note 7)	**3,071,262**	2,424,011
	56,744,160	51,810,316
Income from banking and other related financial services*	**6,456,347**	5,643,307
Savings and loan services:		
Interest and fees on loans	**32,339,256**	27,440,583
Income on investments	**2,002,560**	1,448,256
Other revenues, including sale of developed real estate in 1975 of $3,402,500	**4,075,318**	368,492
	38,417,134	29,257,331
Expenses:		
Interest	**23,381,797**	19,625,203
Operating expenses, including cost of developed real estate sold in 1975 of $3,567,761	**9,552,991**	4,814,847
Federal and state income taxes (note 7)	**1,370,597**	1,161,789
	34,305,385	25,601,839
Income from savings and loan services including amounts appropriated to reserves of $1,800,000 ($1,300,000 in 1974)*	**4,111,749**	3,655,492
Equity increase in unconsolidated subsidiaries*:		
Insurance services	**2,207,204**	3,196,987
Musical instrument operations before cumulative effect of a change in accounting principle in 1974	**3,411,852**	1,183,471
Electronic operations	**—**	92,567
	5,619,056	4,473,025
Unallocated holding company expenses:		
Interest	**6,089,002**	5,748,248
Administrative	**3,130,044**	2,483,647
	9,219,046	8,231,895
Federal income tax credit on unallocated expenses (note 7)	**(4,533,000)**	(4,098,800)
	4,686,046	4,133,095
Income before cumulative effect of a change in accounting principle	**11,501,106**	9,638,729
Cumulative effect of a change in accounting principle (note 2)	**—**	1,377,000
Net income (note 2)	**$11,501,106**	$11,015,729
Primary income per common share:		
Before cumulative effect of a change in accounting principle	**$1.75**	$1.56
Net inome	**$1.75**	$1.82
Fully diluted income per common share:		
Before cumulative effect of a change in accounting principle	**$1.54**	$1.36
Net inome	**$1.54**	$1.57

*Before deduction of unallocated holding company interest and administrative expenses.

See accompanying notes to consolidated financial statements.

D. H. Baldwin Company and Consolidated Subsidiaries

Consolidated Balance Sheets

December 31, 1975 and 1974

Assets	1975	1974
Cash and due from banks, including certificates of deposit of $13,750,000 ($15,400,000 in 1974)	**$ 109,864,785**	$ 119,744,818
Investment securities (notes 3 and 6):		
U.S. Government and agencies	**50,487,421**	52,651,617
Obligations of states and political subdivisions	**55,133,151**	58,549,297
Corporate stocks and other	**8,900,726**	7,431,496
Total investment securities	**114,521,298**	118,632,410
Loans and other receivables (notes 2, 4, 6 and 9)	**860,820,257**	772,605,779
Less: Unearned interest	**32,366,977**	27,297,889
Undisbursed portion of mortgage loans	**11,393,873**	7,128,406
Allowance for losses	**5,188,314**	5,389,715
Net loans and other receivables	**811,871,093**	732,789,769
Federal funds sold and securities purchased under agreements to resell	**34,150,000**	19,870,000
Investment in and advances to unconsolidated subsidiaries, at cost plus equity increases since dates of acquisition or organization (notes 1, 2, 9 and 10):		
Insurance services (after deducting unrealized loss on marketable equity securities of $2,313,609 in 1975)	**27,833,489**	28,464,838
Musical instrument operations	**21,098,995**	18,072,790
Other	**267,987**	—
Total investments and advances	**49,200,471**	46,537,628
Property and equipment, at cost less accumulated depreciation of $7,833,734 ($7,003,864 in 1974) (note 5)	**25,864,666**	23,118,451
Excess of cost of consolidated subsidiaries over the Company's share of the fair value of net underlying assets at dates of acquisition, net of amortization (note 10)	**24,603,650**	24,165,472
Other assets	**18,520,179**	19,400,517
	$1,188,596,142	$1,104,259,065
Liabilities and Stockholders' Equity		
Time and savings deposits	**$ 644,440,198**	$ 581,908,181
Demand deposits	**250,666,545**	236,092,256
Notes and mortgages payable (note 5):		
Due in one year	**23,021,872**	23,789,536
Due after one year	**66,937,056**	48,618,493
Total notes and mortgages payable	**89,958,928**	72,408,029
Federal funds purchased and securities sold under agreements to repurchase	**26,600,000**	29,350,000
Advances from Federal Home Loan Bank (note 6)	**51,364,268**	61,641,584
Advances by borrowers for taxes and insurance	**8,709,427**	7,688,445
Accounts payable and other liabilities	**15,581,867**	18,534,308
Taxes on income, of which $3,004,469 is deferred ($993,170 in 1974) (note 7)	**2,719,619**	2,169,473
Total liabilities	**1,090,040,852**	1,009,792,276
Stockholders' equity (notes 5, 8 and 10):		
Cumulative preferred stock, par value	**35,075,872**	39,257,947
Difference between par value and fair value of preferred stock issued	**(3,955,093)**	(4,139,247)
Common stock, without par value (stated value $1)	**5,786,416**	5,402,343
Additional capital	**13,641,696**	9,822,683
Unrealized loss on marketable equity securities (note 1B)	**(2,656,420)**	—
Retained earnings (including appropriated reserves of savings and loan services from date of acquisition of $6,364,254 and $4,564,254, respectively)	**56,803,084**	50,091,680
	104,695,555	100,435,406
Less cost of treasury shares	**6,140,265**	5,968,617
Total stockholders' equity	**98,555,290**	94,466,789
Commitments and contingent liabilities (note 9).		
	$1,188,596,142	$1,104,259,065

See accompanying notes to consolidated financial statements.

D. H. Baldwin Company and Consolidated Subsidiaries

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 1975 and 1974

	Capital Stock		Difference Between Par Value and Fair Value of Preferred Stock Issued	Additional Capital	Retained Earnings	Treasury Shares
	Total Preferred Stock	Common Stock				
Balance, December 31, 1973	$13,676,779	$5,332,336	$ —	$ 9,254,104	$42,824,328	$ (918,755)
Issuance of preferred shares for purchase of subsidiaries	25,870,302	—	(4,139,247)	—	—	—
Conversions of preferred to common	(289,134)	20,731	—	268,203	—	—
Issuance of shares under employee stock purchase and stock option plans	—	19,088	—	164,530	—	—
Issuance of common shares for purchase of subsidiary	—	30,188	—	135,846	—	—
Transactions in treasury shares	—	—	—	—	—	431,237
Receipt of treasury shares from bank acquisitions	—	—	—	—	—	(5,481,099)
Net income for year	—	—	—	—	11,015,729	—
Dividends paid:						
Preferred stock (Series A, $5.40 per share; Series B, $8.00 per share; Class C, $2.00 per share and Class D, $4.00 per share)	—	—	—	—	(1,349,880)	—
Common stock ($.45 per share)	—	—	—	—	(2,398,497)	—
Balance, December 31, 1974	39,257,947	5,402,343	(4,139,247)	9,822,683	50,091,680	(5,968,617)
Conversions of preferred to common	(4,182,075)	354,851	184,154	3,642,481	—	—
Issuance of shares under employee stock purchase and stock option plans	—	29,222	—	176,532	—	—
Transactions in treasury shares	—	—	—	—	—	(171,648)
Net income for year	—	—	—	—	11,501,106	—
Dividends paid:						
Preferred stock (Series A, $5.40 per share; Series B and Class D, $8.00 per share and Class C, $4.00 per share)	—	—	—	—	(1,890,569)	—
Common stock ($.52 per share)	—	—	—	—	(2,899,133)	—
Balance, December 31, 1975	$35,075,872	$5,786,416	$ (3,955,093)	$13,641,696	$56,803,084	$ (6,140,265)

The unrealized loss on marketable equity securities amounted to $2,656,420 at December 31, 1975.

See accompanying notes to consolidated financial statements.

D. H. Baldwin Company and Consolidated Subsidiaries

Consolidated Statements of Changes in Financial Position

Years Ended December 31, 1975 and 1974

	1975	1974
Source of funds:		
Operations:		
Consolidated net income	**$ 11,501,106**	$ 11,015,729
Add items not requiring funds in the current period	**6,366,158**	1,473,787
Funds provided from operations	**17,867,264**	12,489,516
Increases due to significant acquisitions:		
Deposits	**—**	199,279,634
Debt	**—**	6,142,281
Accounts payable and other liabilities	**—**	3,673,570
Issuance of preferred and common stock	**—**	16,415,990
Increase in debt, net	**7,273,583**	21,800,705
Increase in deposits	**77,106,306**	12,738,182
Decrease in investment securities	**4,111,112**	10,302,743
Decrease in cash	**9,880,033**	—
	$116,238,298	$282,842,621
Use of funds:		
Cash dividends	**$ 4,789,702**	$ 3,748,377
Increases due to significant acquisitions:		
Cash	**—**	22,548,848
Loans	**—**	125,268,775
Investment securities	**—**	61,837,202
Federal funds and other money market obligations, net	**—**	925,000
Property and equipment	**—**	5,610,317
Excess of cost over fair value of assets at dates of acquisition	**—**	8,321,367
Other	**—**	2,181,212
Increase in cash	**—**	5,314,760
Increase in loans and other receivables, net	**80,387,750**	20,090,348
Increase in Federal funds and other money market obligations, net	**17,030,000**	18,933,340
Decrease in accounts payable and other liability accounts, net	**5,646,494**	1,111,694
Purchases of property and equipment, net	**3,991,843**	3,915,723
Other, net	**4,392,509**	3,035,658
	$116,238,298	$282,842,621

See accompanying notes to consolidated financial statements.

1) Accounting Principles

A) Consolidation Policy

D. H. Baldwin Company (Company) is a financial services company with financial subsidiaries engaged in banking and other related financial services, savings and loan activities and insurance, as well as non-financial subsidiaries engaged in musical instrument operations. The Company is a bank holding company by reason of its ownership of twelve banks located in Colorado (collectively called "The Banks") and as such, is subject to the Bank Holding Company Act of 1956, as amended, which regulates the Company's ability to engage in certain types of activities as explained in note 9.

The accompanying consolidated financial statements include the accounts of the Company and all of its subsidiaries engaged in financial services activities, other than insurance, including The Banks, The Empire Savings, Building and Loan Association (Empire) and Baldwin Finance Company (BFC), after adjustment for purchase price accounting (the valuation of the assets acquired and liabilities assumed based on fair values at the dates of acquisitions) and amortization of such adjustments since the dates of purchase. The equity increase of National Farmers Union Service Corporation (NFU) includes amortization of the adjustment for purchase price accounting, and also includes the results of operations of its insurance subsidiaries on the basis of generally accepted accounting principles, which accounting principles differ in some respects from those followed in reports to regulatory authorities.

The Company's investments in unconsolidated subsidiaries engaged in insurance and musical instrument operations are reported on a one-line equity basis. The investment in the insurance subsidiaries has been adjusted for unrealized gains and losses on marketable equity securities at December 31, 1975 as explained in note 1B.

The Company's investment in insurance services results from ownership of convertible participating cumulative preferred stock of NFU, an insurance holding company. NFU owns directly or indirectly 100% of the outstanding common stock of a life insurance company and two casualty insurance companies. Pursuant to an agreement between the Company and NFU, the terms of the preferred shares of NFU held by the Company were amended (in December, 1975) to provide that the mandatory conversion date of such shares be extended from January 1, 1976, to January 1, 1977. The preferred shares remain convertible into 90% of the common shares of NFU, at Baldwin's option, any time prior to the mandatory conversion date.

Corporate interest and administrative expenses incurred by the Company, less the related Federal income tax credit, have not been allocated to the various lines of business in the accompanying consolidated statements of income as it is the Company's policy to allocate only income and expense items that can be directly identified with such lines of business.

All material intercompany transactions and balances have been eliminated.

B) Investment Securities

Investment securities other than marketable equity securities are stated at cost and, if applicable, adjusted for amortization of premiums and accretion of discounts over the terms of the securities. Bonds are not carried at the lower of cost or market since it is management's intention to hold them to maturity.

At December 31, 1975, marketable equity securities of the Company are carried at the lower of cost or market in accordance with Financial Accounting Standards Board Statement No. 12 and marketable equity securities of the Company's insurance subsidiaries are carried at either market or lower of cost or market. A valuation allowance in the amount of $2,656,420 was charged to stockholders' equity representing the net unrealized loss on these marketable equity securities. Gross unrealized gains and (losses) amounted to $88,862 and ($2,745,282), respectively at December 31, 1975. At December 31, 1974, marketable equity securities were carried at cost. Financial statements for the year ended December 31, 1974, have not been restated.

Realized gains and losses are recognized when securities are sold as the difference between net sales proceeds and adjusted cost.

1) Accounting Principles (continued)

C) Loans and Other Receivables
Consumer loans are principally recorded at the amount disbursed plus the interest to be earned over the term of the loan. The interest is recorded as "unearned interest" and amortized to operating income principally using the sum-of-the-digits method.

A portion of loan orgination fees received by Empire are taken into current income with the balance deferred to future periods.

D) Allowance for Losses
It is the policy of The Banks to provide for loan losses through a charge to operations based on a historical five year moving average of net loan losses to outstanding loans. BFC and newly organized banks provide an allowance for doubtful accounts through a charge to operations based on a percentage of new business. Empire's policy is to charge operations for estimated losses on specific loans where any significant and permanent decline reduces the market value of the underlying security to less than the loan. Such losses are usually indicated during foreclosure proceedings. Such allowances (as are allowances for losses on all remaining receivables) are adjusted for such other factors which, in management's judgment, deserve recognition in estimating possible loan losses.

E) Intangibles
The amount of $21,735,424 at December 31, 1975, by which the Company's cost of certain consolidated and unconsolidated subsidiaries acquired prior to November 1,1970, exceeds its share of the fair value of the net assets of such subsidiaries at the dates of acquisition, is not being amortized because, in the opinion of management, its value has not diminished. The amount of excess costs of $8,970,306 of certain subsidiaries acquired after November 1, 1970, is being amortized in accordance with Accounting Principles Board Opinion No. 17. The amortization period used by the Company is forty years.

F) Income Taxes
Deferred Federal income taxes have been provided for income and expenses which enter into the determination of pre-tax accounting income and taxable income in different periods.

Investment tax credits, which are not material, have been accounted for on the "flow-through" method, which recognizes the benefit in the year in which the assets giving rise to the credit are placed in service.

G) Appropriated Reserves of Savings and Loan Services
The appropriated reserves (retained earnings) have been established in accordance with rules and regulations of supervisory authorities solely for the purpose of absorbing future losses, if any.

H) Retirement Plans
The Company and its subsidiaries maintain various contributory and non-contributory pension plans covering all eligible employees. The companies accrue all actuarially determined costs. Past service costs are being amortized over periods ranging from approximately 25 to 40 years. Unamortized prior service costs are not material. The policy is to fund pension costs. Under certain plans, the Company has chosen to accrue the minimum contribution requirements as actuarially determined under the plans. Vested benefits at December 31, 1975 do not exceed pension fund balances. Pension expenses amounted to approximately $980,700 and $856,200 for the two years ended December 31, 1975, respectively. Management anticipates no significant increase in future pension expense as a result of the Employee Retirement Income Security Act of 1974.

I) Net Income Per Share
Primary income per common share has been computed based on the weighted average number of shares outstanding during each period, after consideration of preferred dividend requirements. Primary income per share for 1975 would have been $1.66 calculated on the basis that all conversions of preferred shares since January 1, 1975, to February 2, 1976 had taken place at the beginning of 1975. Fully diluted income per share has been computed assuming conversion of the Series A and Series C-2 and C-3 preferred shares and elimination of the dividend requirement thereon.

2) Supplemental Financial Information

Condensed balance sheets of D. H. Baldwin Company (Parent only) at December 31, 1975 and 1974 with its investments in subsidiaries recorded on a one-line equity basis are as follows:

	1975	1974
Assets:		
Cash	**$ 547,951**	$ 4,855,675
Receivables	**461,033**	539,244
Investments and advances:		
Financial services subsidiaries including advances of $1,431,451 ($3,830,021 in 1974)	**104,338,319**	94,743,299
Insurance services (after deducting unrealized loss on marketable equity securities in 1975 of $2,313,609)	**27,833,489**	28,014,838
Musical instrument operations including an advance of $1,072,681 (net of a payable of $541,673 in 1974)	**25,098,995**	18,072,790
Other, including an advance of $123,794	**267,987**	—
Total investments and advances	**157,538,790**	140,830,927
Property and equipment, at cost less accumulated depreciation of $433,871 ($2,734,036 in 1974)	**954,708**	1,967,532
Deferred charges and other assets, including deferred Federal income tax charges of $828,650 ($2,433,647 in 1974)	**7,056,077**	9,349,646
	$166,558,559	$157,543,024
Liabilities and Stockholders' Equity:		
Notes payable and commercial paper	**$ 2,929,500**	$ 16,013,000
Long-term debt, including a current portion of $5,335,400 ($3,371,387 in 1974)	**61,444,096**	43,081,282
Accounts payable and other liabilities	**2,523,598**	1,605,637
Taxes on income	**1,106,075**	2,376,316
Total liabilities	**68,003,269**	63,076,235
Stockholders' equity	**98,555,290**	94,466,789
	$166,558,559	$157,543,024

Condensed statements of income for D. H. Baldwin Company (Parent only) for the two years ended December 31, 1975 are as follows:

	1975	1974
Equity increases in investments:		
Financial services subsidiaries including adjustments for purchase price accounting of $1,147,057 ($1,450,329 in 1974)	**$ 13,165,765**	$ 12,835,431
Musical instrument operations before cumulative effect of a change in accounting principle in 1974	**3,411,852**	1,183,471
Electronic operations	**—**	92,567
Total equity increases in investments	**16,577,617**	14,111,469
Expenses:		
Administrative	**3,063,018**	2,592,175
Interest:		
Long-term debt	**5,153,089**	4,030,075
Other	**1,519,969**	2,478,590
Total interest	**6,673,058**	6,508,665
Total expenses	**9,736,076**	9,100,840
Income before Federal income tax credit and cumulative effect of a change in accounting principle	**6,841,541**	5,010,629
Federal income tax credit	**4,659,565**	4,628,100
Income before cumulative effect of a change in accounting principle	**11,501,106**	9,638,729
Cumulative effect of a change in accounting principle	**—**	1,377,000
Net Income	**$ 11,501,106**	$ 11,015,729

2) Supplemental Financial Information (continued)

Condensed statements of changes in financial position for D.H. Baldwin Company (Parent only) for the two years ended December 31, 1975 are as follows:

	1975	1974
Source of funds:		
Operations:		
Net income	**$ 11,501,106**	$ 11,015,729
Add (deduct) items not requiring (providing) funds in the current period:		
Equity increase in investments	**(16,577,617)**	(15,488,469)
Less dividends from subsidiaries	**7,032,475**	8,145,181
	(9,545,142)	(7,343,288)
Other, net	**3,888,126**	(1,201,463)
Funds provided from operations	**5,844,090**	2,470,978
Proceeds from issuance of long-term debt	**22,870,917**	2,720,600
Increase in short-term debt	**—**	2,296,500
Payments from subsidiaries, net	**—**	3,315,515
Issuance of preferred and common stock in acquisitions	**—**	16,415,990
Assumption of debt of companies merged in 1974, net	**—**	221,450
Decrease in property and equipment, net	**854,212**	—
Decrease in cash	**4,307,724**	1,301,337
Other, net	**1,569,693**	—
	$ 35,446,636	$ 28,742,370
Use of funds:		
Cash dividends	**$ 4,789,702**	$ 3,748,377
Payments to subsidiaries, net	**7,443,038**	—
Investment in subsidiaries	**2,042,755**	19,345,276
Increase in property and equipment, net	**—**	776,682
Payments on long-term debt	**4,508,103**	1,634,768
Decrease in liability for taxes on income	**3,579,538**	2,143,675
Decrease in short-term debt	**13,083,500**	—
Other, net	**—**	1,093,592
	$ 35,446,636	$ 28,742,370

2) Supplemental Financial Information (continued)

Condensed statements of net assets employed in the financial services lines of business at December 31, 1975 and 1974 are as follows:

December 31, 1975:	Banking and Other Related Financial Services	Savings and Loan Services	Insurance Services
Assets:			
Cash and due from banks	$ 78,167,382	$ 31,149,452	$ 2,950,904
Investment securities:			
U.S. Government and agencies	50,148,786	338,635	1,754,295
Obligations of states and political subdivisions	55,133,151	—	21,679,098
Other	4,481,326	4,419,400	34,740,240
Total investment securities	109,763,263	4,758,035	58,173,633
Loans and other receivables:			
Mortgage loans	74,444,929	382,481,911	7,382,394
Commercial and industrial loans	180,722,013	—	—
Consumer loans	190,319,187	909,454	2,290,552
Other loans and receivables	30,574,923	906,807	9,544,951
Total	476,061,052	384,298,172	19,217,897
Less: Unearned interest	32,366,977	—	—
Allowance for losses	5,127,706	60,608	68,462
Undisbursed portion of mortgage loans	—	11,393,873	—
Net loans and other receivables	438,566,369	372,843,691	19,149,435
Federal funds sold and securities purchased under agreements to resell	34,150,000	—	—
Property and equipment, at cost less accumulated depreciation	16,394,481	8,515,477	2,660,440
Excess of cost of subsidiaries over the Company's share of the fair value of net underlying assets at dates of acquisition	15,466,774	9,136,876	5,754,771
Unamortized insurance acquisition costs	—	—	14,054,241
Other	8,763,335	4,920,342	4,170,125
Total assets	701,271,604	431,323,873	106,913,549
Liabilities:			
Deposits:			
Demand	250,666,545	—	—
Savings	151,226,190	122,040,808	—
Time	163,447,036	207,726,164	—
	565,339,771	329,766,972	—
Notes and mortgages payable	22,960,648	2,624,684	964,446
Other borrowings	26,600,000	51,364,268	—
Insurance reserves	—	—	65,687,757
Advances by borrowers for taxes and insurance	—	8,709,427	—
Other liabilities	13,789,977	3,101,411	9,871,493
Minority interest	—	—	2,556,364
Total liabilities	628,690,396	395,566,762	79,080,060
Net assets employed	$ 72,581,208	$ 35,757,111	$ 27,833,489

2) Supplemental Financial Information (continued)

December 31, 1974:	Banking and Other Related Financial Services	Savings and Loan Services	Insurance Services
Assets:			
Cash and due from banks	$ 98,231,784	$ 16,657,359	$ 738,278
Investment securities:			
U.S. Government and agencies	51,739,897	911,720	1,819,076
Obligations of states and political subdivisions	58,549,297	—	15,803,916
Other	2,294,696	5,136,800	37,226,215
Total investment securities	112,583,890	6,048,520	54,849,207
Loans and other receivables:			
Mortgage loans	73,661,186	334,541,436	7,144,597
Commercial and industrial loans	167,014,555	—	—
Consumer loans	180,074,666	—	2,023,524
Other loans and receivables	15,138,093	1,636,599	7,682,112
Total	435,888,500	336,178,035	16,850,233
Less: Unearned interest	27,297,889	—	—
Allowance for losses	5,379,712	10,000	47,640
Undisbursed portion of mortgage loans	—	7,128,406	—
Net loans and other receivables	403,210,899	329,039,629	16,802,593
Federal funds sold and securities purchased under agreements to resell	19,870,000	—	—
Property and equipment, at cost less accumulated depreciation	13,951,402	7,199,517	2,651,723
Excess of cost of subsidiaries over the Company's share of the fair value of net underlying assets at dates of acquisition	15,028,594	9,136,876	5,754,771
Unamortized insurance acquisition costs	—	—	12,116,566
Other	8,545,343	5,363,653	3,731,190
Total assets	671,421,912	373,445,554	96,644,328
Liabilities:			
Deposits:			
Demand	236,092,256	—	—
Savings	112,466,404	100,722,389	—
Time	202,657,110	166,062,278	—
	551,215,770	266,784,667	—
Notes and mortgages payable	10,713,633	2,600,114	994,738
Other borrowings	29,350,000	61,641,584	—
Insurance reserves	—	—	56,164,614
Advances by borrowers for taxes and insurance	—	7,688,445	—
Other liabililties	17,930,275	2,199,679	8,416,540
Minority interest	—	—	2,603,598
Total liabilities	609,209,678	340,914,489	68,179,490
Net assets employed	$ 62,212,234	$ 32,531,065	$28,464,838

2) Supplemental Financial Information (continued)

Condensed income statements of National Farmers Union Service Corporation and Subsidiaries for the two years ended December 31, 1975 are as follows:

	1975	1974
Life insurance services:		
Premiums and other considerations	**$17,160,639**	$14,531,455
Net investment income	**2,743,916**	2,474,619
Total income	**19,904,555**	17,006,074
Insurance benefits and expenses	**17,878,059**	14,884,201
Income before provision for income taxes	**2,026,496**	2,121,873
Provision for income taxes	**117,274**	118,446
Income before realized investment gains and losses	**1,909,222**	2,003,427
Realized investment gains (losses), net of tax	**14,191**	(32,310)
Net income from life insurance services	**1,923,413**	1,971,117
Property and casualty services:		
Premiums earned	**35,068,464**	30,652,832
Net investment income	**3,272,118**	2,867,131
Total income	**38,340,582**	33,519,963
Losses and loss adjustment expenses	**26,320,463**	20,289,480
Underwriting and operating expenses	**11,089,046**	10,014,223
Total expenses	**37,409,509**	30,303,703
Income before provision for income taxes	**931,073**	3,216,260
Provision (credit) for income taxes	**(106,563)**	1,065,080
Income before investment gains	**1,037,636**	2,151,180
Realized investment gains, net of tax	**19,240**	47,263
Net income from property and casualty services	**1,056,876**	2,198,443
Combined net income from insurance services	**$ 2,980,289**	$ 4,169,560
Reconciliation to D. H. Baldwin Company equity increase:		
Combined net income from insurance services	**$ 2,980,289**	$ 4,169,560
Less:		
10% minority interest	**298,029**	416,956
Income taxes on equity increase	**171,450**	160,200
Intercompany interest, net of income taxes	**303,606**	395,417
D. H. Baldwin Company equity increase	**$ 2,207,204**	$ 3,196,987

Unrealized appreciation (depreciation) of marketable equity securities during 1975 and 1974 was $1,685,468 and ($3,110,797), respectively.

2) Supplemental Financial Information (continued)

Condensed balance sheets of the consolidated musical instrument operations as of December 31, 1975 and 1974 and condensed income statements for the years then ended are as follows:

Condensed Balance Sheets

	1975	1974
Assets:		
Current assets:		
Cash	**$ 1,887,788**	$ 2,557,378
Commercial paper issued by an affiliated finance company	**5,825,000**	—
Accounts receivable, net of allowance for losses of $828,722 ($834,712 in 1974)	**10,782,119**	9,228,611
Inventories at the lower of cost (last-in, first-out) or market	**16,862,138**	25,419,099
Due from affiliates	**83,975**	662,125
Prepaid expenses	**374,604**	621,904
Total current assets	**35,815,624**	38,489,117
Property, plant and equipment, net of accumulated depreciation of $5,888,553 ($5,235,897 in 1974)	**7,802,556**	6,703,443
Due from parent	**—**	541,673
Investment in an affiliated finance company	**4,000,000**	—
Other assets	**216,786**	2,152,417
	$47,834,966	$47,886,650
Liabilities and Stockholder's Equity:		
Current liabilities:		
Notes payable, banks	**$ —**	$18,125,000
Current installments of long-term debt and capitalized lease obligations	**669,520**	150,000
Accounts payable	**632,672**	1,429,494
Accrued expenses	**3,469,534**	2,364,698
Total current liabilities	**4,771,726**	22,069,192
Long-term debt, less current portion	**9,500,000**	—
Due to parent	**1,072,681**	—
Other liabilities, including capitalized lease obligations	**7,464,245**	6,202,996
Deferred Federal income taxes	**1,000,000**	1,000,000
Stockholder's equity	**24,026,314**	18,614,462
	$47,834,966	$47,886,650

Condensed Income Statements

Net sales	**$76,841,227**	$73,517,395
Cost of goods sold	**53,500,908**	56,942,675
Gross profit on sales	**23,340,319**	16,574,720
Other revenues	**425,109**	428,857
Gross profit	**23,765,428**	17,003,577
Selling, general and administrative expenses, including depreciation of $1,037,334 ($849,368 in 1974)	**17,321,576**	15,254,406
Income before Federal income taxes and cumulative effect of a change in accounting principle in 1974	**6,443,852**	1,749,171
Federal income taxes	**3,032,000**	565,700
Income before cumulative effect of a change in accounting principle	**3,411,852**	1,183,471
Cumulative effect of a change in accounting principle, net of Federal income taxes	**—**	1,377,000
Net income	**$ 3,411,852**	$ 2,560,471

2) Supplemental Financial Information (continued)

Effective with the year ended December 31, 1974, the Company's subsidiary, Baldwin Piano & Organ Company changed its method of overhead allocation and adopted the policy of allocating overhead to inventory in process. The effect of not allocating overhead to inventory in process on income for prior years and the related balance sheets was not material. This change in accounting principle, which was made to more closely reflect the actual cost of inventory in process and is also in conformity with IRS requirements, increased the recorded value of inventories by approximately $1,844,000 at December 31, 1974. The cumulative effect as of December 31, 1973 increased net income in 1974 by $1,377,000 (net of Federal income tax).

Treasury Regulations, which became effective in September, 1973, allow a portion of the income resulting from the change in overhead allocation policy attributable to the December 31, 1953 inventories to be excluded from taxable income. The amount the Company so excluded was approximately $960,000.

Effective with the year ended December 31, 1974, Baldwin Piano & Organ Company changed its method of valuing a material portion of inventories from the first-in, first-out (FIFO) method to the last-in, first-out (LIFO) method. This change was made because management believes LIFO more closely matches current costs with current revenues in an inflationary period. There is no cumulative effect of the change on prior years since the December 31, 1973 inventory as previously stated is also the amount of the beginning inventory under the LIFO method. If the FIFO method of inventory accounting had been used by Baldwin Piano & Organ Company, inventories would have been approximately $1,133,000 higher at December 31, 1975 and $1,130,000 higher at December 31, 1974.

The D. H. Baldwin Trust also adopted the LIFO method of inventory valuation in 1974. Under the terms of the agreement with the Trust, Baldwin Piano & Organ Company's income was reduced by the amount of the LIFO adjustment.

The effect of the above changes on income and earnings per share for the year ended December 31, 1974 are as follows:

		Income Per Share	
	Income	Primary	Fully Diluted
Decrease resulting from change to LIFO	$(1,348,000)	$(.26)	$(.21)
Increase (attributable to the year ended December 31, 1974) resulting from a change in accounting principle — overhead allocation policy	39,900	.01	.01
	(1,308,100)	(.25)	(.20)
Increase resulting from the cumulative effect of the change in accounting principle — overhead allocation policy	1,377,000	.26	.21
	$ 68,900	$ .01	$ .01

Musical instrument inventories of the D. H. Baldwin Trust (purchased from Baldwin Piano & Organ Company) amounted to approximately $12,089,000 and $15,297,000 at December 31, 1975 and 1974, respectively. If the identified cost method of inventory accounting had been used by the Trust, inventories would have been approximately $2,756,000 higher at December 31, 1975 and $1,444,000 higher at December 31, 1974. The Trust has shipped these instruments on consignment to Baldwin musical instrument dealers. At December 31, 1975 and 1974, the Trust had issued notes payable to banks of $11,500,000 and $15,500,000, respectively.

During 1975, inventory quantities were reduced. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in 1974 and 1973 as compared to the costs of 1975 purchases, the effect of which increased net income by approximately $650,000 or $.12 per share.

3) Investment Securities

The market values of investment securities were as follows:

	December 31, 1975	December 31, 1974
U.S. Government and agencies	**$ 50,492,934**	$ 52,425,879
Obligations of states and political subdivisions	**51,243,275**	52,894,220
Corporate stocks and other	**8,528,140**	7,534,482
Total	**$110,264,349**	$112,854,581

The approximate amortized cost of investment securities pledged by The Banks to secure public funds on deposit amounted to $65,175,606 at December 31, 1975 and $89,318,750 at December 31, 1974.

4) Allowance for Losses

A summary of the changes in the allowance for loan losses is as follows:

	December 31, 1975	December 31, 1974
Balance at beginning of year	**$ 5,389,715**	$ 3,343,759
Allowance for losses of purchased banks at dates of acquisition	**70,038**	1,824,586
Provision charged to operating expenses	**3,293,410**	2,219,304
Less loans charged off, net of recoveries	**(3,564,849)**	(1,997,934)
Balance at end of year	**$ 5,188,314**	$ 5,389,715

5) Notes and Mortgages Payable (Short and Long-term)

	December 31, 1975	December 31, 1974
Banks:		
Note payable dated December 29, 1972, bearing interest at 110% of the bank's prime rate (but not to exceed an average of 8% during the period from December 29, 1972 to December 31, 1977), payable in installments of $625,000 semi-annually 1975 through 1978, and $1,250,000 semi-annually 1979 and 1980	**$ 8,750,000**	$10,000,000
Note payable dated December 13, 1972, bearing interest at 1% above the six month rate at which United States dollars are offered to prime banks in the London Interbank Market, effective rate of 8¼% at January 1, 1976 (11⅜% at January 1, 1975), payable in installments of $125,000 semi-annually 1975 through 1978 and $250,000 semi-annually 1979 and 1980	**1,750,000**	2,000,000
Note payable bearing an 8⅜% interest rate with principal payable $1,000,000 annually through 1975, and a final payment of $2,000,000 due in 1976	**2,000,000**	3,000,000
Note payable dated December 31, 1974, under a revolving credit agreement expiring on December 31, 1977, bearing interest on U.S. dollars at 1% in excess of 125% of the bank's prime rate and for Eurodollars, 1½% in excess of the rate that the bank determines to be effective in the London Interbank Market; effective rate of 10% at December 31, 1975 (12% at December 31, 1974)	**1,500,000**	1,500,000

5) Notes and Mortgages Payable (Short and Long-term) (continued)

	December 31,	
	1975	**1974**
Banks (continued):		
Note payable bearing a 7½ % interest rate with principal payable $200,000 semi-annually commencing April 1, 1978 and having a final installment of $1,200,000 plus accrued interest payable on April 1, 1980	**2,000,000**	2,000,000
Note payable, non-interest bearing, due in equal annual installments of $5,000	**15,000**	20,000
Short-term notes bearing interest at 7% to 7¼ % at December 31, 1975 (7% to 12% at December 31, 1974)	**7,221,472**	15,865,081
	23,236,472	34,385,081
Other:		
8½ % notes dated December 1, 1972, due December 1, 1992, $670,000 payable annually 1979 through 1991, with the balance due 1992	**12,000,000**	12,000,000
8% note payable with principal amounts payable in varying amounts through April 1, 1992, of which $356,000 is due in 1976 ($716,000 in 1975)	**8,677,000**	9,393,000
Note payable to National Farmers Union Service Corporation and subsidiaries due in four equal installments of $1,250,000 commencing December 31, 1978. A prepayment of $1,250,000 was made in December, 1973 and $800,000 and $250,000 in February and March, 1975. Such prepayments are made in inverse order of due date. Interest is payable quarterly at a fixed rate of 9% and additional interest is payable annually at a rate not to exceed 11%	**2,700,000**	3,750,000
9% note payable with principal amounts of $104,995 due annually January 31, 1985 through 1989 and a final payment of $524,974 due January 31, 1990. A prepayment of $150,000 was made in July, 1975. Such prepayments are made in inverse order of due date	**899,948**	—
9% notes, payable in four equal principal amounts of $7,000 annually June 25, 1975 through 1978 with a final payment of $42,000 due on or before June 25, 1979	**63,000**	—
5¾ % note payable with principal amounts payable in varying amounts monthly through October, 1976	**19,637**	—
Commercial paper bearing interest at 6% to 9½ % at December 31, 1975 (6% to 10½ % at December 31, 1974)	**9,884,500**	3,957,855
5¼ % subordinated capital debenture, payable $200,000 annually	**1,800,000**	2,000,000
7¾ % subordinated capital notes, total due February 28, 1983	**1,800,000**	1,800,000
9¼ % debentures due October 15, 1984	**2,777,800**	493,500
9¾ % debentures due October 15, 1989	**7,161,200**	727,100
9% subordinated capital notes due 1980	**3,915,800**	—
9¾ % subordinated capital notes due 1985	**6,084,200**	—
9% subordinated capital notes, $293,322 maturing annually July 15, 1985 through 1989 and $1,466,609 due July 15, 1990	**2,933,217**	—
	60,716,302	34,121,455
Mortgages payable in monthly installments aggregating $67,881 ($45,313 in 1974) including interest at rates of 4⅝% to 10⅜% (4⅝% to 8% in 1974) with maturities ranging from 1978 to 1995, secured by property and equipment with an approximate carrying value of $7,801,300 and investment of real estate of approximately $2,321,400 at December 31, 1975 ($7,168,100 and $1,395,700 at December 31, 1974).	**6,006,154**	3,901,493
	$89,958,928	$72,408,029

5) Notes and Mortgages Payable (Short and Long-term) (continued)

The approximate maturities of long-term notes and mortgages payable for the five years ended December 31, 1980 are $5,915,900, $5,163,100, $5,549,700, $7,528,300 and $10,137,800, respectively.

The notes dated December 1, 13, and 29, 1972, the Series A and B Debentures due 1984 and 1989, and the Series A and B Subordinated Capital Notes due 1980 and 1985, contain certain restrictions as to the creation of liens, new indebtedness, leases and investments, and have limitations as to the payment of dividends in cash or other property and retirement of capital stock. Under the most restrictive covenants, as amended on April 30, 1973, $850,000 plus 75% of the net income of the Company earned after December 31, 1972, will be available for payment of dividends or retirement of capital stock, subject to the net worth of certain subsidiaries meeting certain defined tests. At December 31, 1975, $14,837,190 was available for the payment of dividends or retirement of capital stock ($11,172,710 at December 31, 1974).

In 1974, the Company offered for sale 9¼% Series A Debentures due 1984 and 9¾% Series B Debentures due 1989. The Debentures are unsecured debt obligations of D. H. Baldwin Company and are not obligations of any of its subsidiaries. The Series A Debentures are not redeemable at the option of the Company prior to maturity. The Series B Debentures may be redeemed at the option of the Company on and after October 15, 1984 at 100% of their principal amount plus accrued interest. The debentures are redeemable at the option of the holder but only to the extent of 5% of all outstanding debentures in any one year. The total amount of the debenture offering of $10,000,000 was completely sold in February, 1975. Proceeds were used to repay short-term obligations.

In 1975, the Company offered for sale 9% Series A Subordinated Capital Notes due 1980 and 9¾% Series B Subordinated Capital Notes due 1985. The capital notes are direct, unsecured debt obligations of the Company and are subordinated to all present and future indebtedness of the Company for borrowed money and are not obligations of any of its subsidiaries. The notes are redeemable at the option of the holder but only to the extent of 5% of all outstanding notes in any one year. The offering of $10,000,000 was sold in June, 1975, with the proceeds being used to reduce short-term obligations.

The Company is in the process of registering Subordinated Capital Notes in the amount of $15,000,000. Proceeds from the sale of the 1976 Notes will be used to pay short-term debt and the current portion of long-term debt due in 1976 and 1977.

6) Advances From Federal Home Loan Bank

The advances from the Federal Home Loan Bank of Topeka are secured by real estate loans with balances at December 31, 1975 and 1974 of approximately $85,000,000 and $96,000,000, respectively, and by the Association's investment in the capital stock of that bank. The weighted average interest for such advances are 7.8% and 8.5% at December 31, 1975 and 1974, respectively.

The annual aggregate maturities of the advances as of December 31, 1975 are as follows:

1976	$ 1,888,218
1978	12,988,541
1979	27,664,002
1980	1,573,507
1985	7,250,000
	$51,364,268

7) Income Taxes

The components of the income tax provisions (credits) for the Company and its consolidated subsidiaries by line of business are as follows:

	1975	1974
Banking and other related financial services:		
Federal provision:		
Current	**$ 1,793,123**	$ 1,556,640
Deferred	**949,590**	644,947
	2,742,713	2,201,587
State provision	**328,549**	222,424
	$ 3,071,262	$ 2,424,011
Savings and loan services:		
Federal provision:		
Current	**$ 1,282,554**	$ 1,049,775
Deferred	**(10,809)**	19,250
	1,271,745	1,069,025
State provision	**98,852**	92,764
	$ 1,370,597	$ 1,161,789
Parent:		
Federal credit:		
Current	**$ (7,859,400)**	$ (3,190,771)
Deferred	**3,326,400**	(908,029)
	$ (4,533,000)	$ (4,098,800)

The equity in the earnings of unconsolidated subsidiaries are shown net of income taxes, including a provision for taxes on the undistributed earnings of NFU, in the accompanying consolidated statements of income.

Deferred tax expense results from timing differences in the recognition of income and expense for tax and financial statement reporting purposes. The sources of these significant differences and the tax effect of each for the years ended December 31, 1975 and 1974 were as follows:

	1975	1974
Banking and other related financial services:		
Net effect of reporting on the cash basis for income tax purposes	**$ 139,000**	$ 126,000
Income on leases recognized on finance method for books and on operating method for tax purposes	**836,800**	414,600
Excess of joint venture losses for tax purposes over book losses	**—**	27,000
Additional provision for loan losses	**112,000**	96,000
Other	**(138,210)**	(18,653)
	$ 949,590	$ 644,947
Parent:		
Difference between book and tax income resulting from the use of the installment method of reporting the sales of Baldwin Piano & Organ Company for tax purposes	**$ 2,794,000**	$ —
Excess of joint venture losses for tax purposes over book losses	**96,000**	79,000
Difference between book and tax income resulting from sales of installment receivables, net	**521,000**	(744,000)
Other	**(84,600)**	(243,029)
	$ 3,326,400	$ (908,029)

7) Income Taxes (continued)

It is not expected that the cash outlay for income taxes will substantially exceed income tax expenses in the next three years.

The difference between the taxes provided in the accompanying consolidated income statement and the amount which would be computed by applying the U.S. Federal income tax rate of 48% to income before taxes is explained as follows:

	1975	1974
Banking and other related financial services:		
Computed expected tax expense	**$ 4,573,000**	$ 3,872,000
Tax exempt interest	**(1,399,000)**	(1,086,000)
Investment tax credits	**(144,000)**	(245,000)
Amortization of tax effected purchase price adjustments	**(160,000)**	(236,000)
Other	**201,262**	119,011
	$ 3,071,262	$ 2,424,011
Savings and loan services:		
Computed expected tax expense	**$ 2,632,000**	$ 2,312,000
Allowable bad debt deduction, net of minimum tax	**(1,049,000)**	(908,000)
Amortization of tax effected purchase price adjustment	**(249,000)**	(315,593)
Other	**36,597**	73,382
	$ 1,370,597	$ 1,161,789

In accordance with the provisions of the Internal Revenue Code, Empire has appropriated for specific tax bad debt reserves approximately $21,000,000 through December 31, 1975 (of which approximately $13,100,000, including a current appropriation of approximately $2,400,000, has been appropriated since its acquisition by the Company in 1968) as a deduction from taxable income for which, in accordance with generally accepted accounting principles, deferred income taxes have not been provided. If, in the future, these reserves are charged for any purpose other than to absorb bad debt losses, a tax liability will be imposed upon Empire at the then current Federal income tax rate.

The Company files consolidated Federal income tax returns with all its subsidiaries except NFU. NFU files a consolidated Federal income tax return with its eligible subsidiaries, and its life insurance subsidiary files a separate return.

The life insurance subsidiary of NFU is subject to taxation under the provisions of the Life Insurance Income Tax Act of 1959 which provides generally that one-half of the excess, if any, of gains from operations over taxable investment income, less certain special deductions is taxable to the life insurance company only when distributed to stockholders as dividends. In accordance with generally accepted accounting principles, deferred income taxes have not been provided. Such accumulated amount is estimated at approximately $2,100,000 as of December 31, 1974 and 1975. If, in the future, the income is distributed to stockholders, a tax liability will be imposed upon the NFU Service life insurance subsidiary at the then current Federal income tax rate.

The Company's Federal income tax returns for the years 1972 and 1973 were examined during 1975. The examining agent has proposed adjustments which, if sustained, will result in additional Federal income taxes for those years and reduced Federal income taxes for later years. The settlement of these issues is not expected to have a material effect on the financial statements of the Company.

8) Capital Stock

A summary of preferred stock transactions follows:

Preferred stock:	1975	1974
Series A 5% convertible (par value $108 per share):		
Beginning of year	**$ 6,509,197**	$ 6,544,117
Conversion into common shares	**(3,267,917)**	(34,920)
Conversion into Series B shares	**(86,330)**	—
End of year	**3,154,950**	6,509,197
Series B 8% (par value $100 per share):		
Beginning of year	**7,132,662**	7,132,662
Conversion from Series A shares	**86,330**	—
End of year	**7,218,992**	7,132,662
Class C 4% convertible — Series 2 (par value $100 per share):		
Beginning of year	**15,500,191**	—
Issuance for purchase of subsidiaries	**—**	18,112,904
Conversion into common shares	**(338,254)**	(92,840)
Conversion into Class D shares	**(2,782,702)**	(2,519,873)
End of year	**12,379,235**	15,500,191
Class C 4% convertible — Series 3 (par value $100 per share):		
Beginning of year	**4,434,292**	—
Issuance for purchase of subsidiary	**—**	7,757,398
Conversion into common shares	**(575,904)**	(161,374)
Conversion into Class D shares	**(973,944)**	(3,161,732)
End of year	**2,884,444**	4,434,292
Class D 8% (par value $100 per share):		
Beginning of year	**5,681,605**	—
Conversion from Class C — Series 2 shares	**2,782,702**	2,519,873
Conversion from Class C — Series 3 shares	**973,944**	3,161,732
End of year	**9,438,251**	5,681,605
Total preferred stock at end of year	**$35,075,872**	$39,257,947

A summary of treasury shares follows:		
Common, 42,742 shares (34,325 shares in 1974)	**$ 440,733**	$ 357,085
Preferred, Series B, 2,331 shares in 1975 (1,331 shares in 1974)	**218,433**	130,433
Preferred, Class C-Series 2, 65,251 shares in 1975 and 1974	**5,481,099**	5,481,099
Total	**$ 6,140,265**	$ 5,968,617

On April 30, 1975, the stockholders approved an increase in the number of authorized common shares from 10,000,000 to 15,000,000 shares.

Each Series A share (authorized 76,046) is convertible into either 1.08 Series B shares (authorized 144,138) or 9.6 common shares. Each Series A and B share is entitled to one vote on any matter submitted to a vote of the common shareholders. The Series A and B shares may be redeemed in whole or in part at the Company's option any time after July 1, 1989 at par value plus all dividends accrued and unpaid thereon. At December 31, 1975, 281,435 common shares were reserved for conversion of the Series A convertible preferred shares.

8) Capital Stock (continued)

In connection with recent acquisitions (note 10), the shareholders of the Company approved, on January 24, 1974, the authorization of 500,000 shares of each of two classes of preferred shares, Class C Cumulative Convertible Preferred Shares, Par Value $100, and Class D 8% Cumulative Preferred Shares, Par Value $100. The Class C Shares may be divided by the Board of Directors of the Company into one or more series, each consisting of such number of shares, bearing such designation and having such dividend rate, redemption date, and rate of conversion into common shares as the Board of Directors shall determine. The new class of preferred shares are voting, redeemable after 1992 and subordinate to Series A and Series B Preferred Shares upon liquidation and in rights to dividends. Series C-2 Shares are convertible into 1.0 shares of Class D Preferred or 6.58 common shares. Series C-3 Shares are convertible into 1.0 shares of Class D Preferred or 7.14 common shares. The conversion rates into common shares so fixed are effective only until the second anniversary of the date upon which the shares are issued. On and after such anniversary date the conversion rate into common shares is reduced by 15%. At December 31, 1975, 385,351 and 206,032 common shares were reserved for the conversion of the Series C-2 and C-3 preferred shares, respectively.

At December 31, 1975, 169,826 common shares were reserved for sale to employees and for the granting and exercising of options under the qualified stock option plan. Under the stock option plan, options may be granted to certain employees to purchase common shares of the Company at a price not less than the market value on the date of granting. Stock options granted and exercised during 1975 and 1974 and outstanding at December 31, 1975 and 1974 were as follows:

	Shares	Option price per share
Options granted		
1975	22,000	$ 8.62
1974	13,011	8.50 — 11.88
Options exercised		
1975	15,442	$6.01 — 8.62
1974	4,826	7.48 — 11.75
Options outstanding		
December 31, 1975	83,821	$8.62 — 15.57
December 31, 1974	89,942	6.01 — 15.57

Options for 1,000 shares were surrendered during 1974 and 1975. Options for 11,681 shares expired during 1975.

In September, 1973, the Board of Directors adopted a plan known as the "Stock Ownership Incentive Plan" under which eligible employees may purchase up to 36,660 shares of the Company's common stock held in the treasury for $11.125. During 1974, 29,674 shares were purchased under this plan. In April, 1974, the plan was amended to include 7,000 additional shares at $11.875. No shares were purchased under this amendment in 1974 or 1975. This plan was discontinued in 1975.

On April 30, 1975, shareholders of the Company approved the adoption of the Employees Stock Ownership Plan for all employees of the Company and of those subsidiaries which adopt the plan. Under the plan, the adopting employer matches employee contributions, on a dollar-for-dollar basis, and the combined contributions are given to an independent trustee for the purpose of purchasing common shares of the Company in the open market. During 1975, 55,483 shares were purchased under this plan.

9) Commitments and Contingent Liabilities

As a result of its ownership of The Banks, the Company is a bank holding company and is subject to regulation by the Board of Governors of the Federal Reserve System (Board) under the Bank Holding Company Act of 1956, as amended.

In June, 1973, the Board completed a required review of the Company and issued an order which permits the Company to continue to engage in both the banking and musical instrument businesses. The June order also reflected an earlier commitment made by the Company that it would divest itself of its investments in electronics. In October, 1974, Baldwin Electronics, Inc. (BEI) sold or leased substantially all of its assets and business to an investors group including many employees of BEI. On December 31, 1974, the Company contributed its investment in Siliconix incorporated (an electronics company) to NFU, at carrying value.

The June, 1973 order referred to in the preceding paragraph further states that the Company must reduce its interest in Empire and NFU to less than 5% of the outstanding voting shares by December 31, 1980, unless the Board approves an application by the Company to retain such shares. Hence, before December 31, 1980, the Company must determine what steps it will take regarding its investment in Empire and NFU. Company management has determined to seek means by which it may continue to own both its banking subsidiaries and Empire. Consequently, on January 28, 1976, the Company filed with the Federal Reserve Board an application for approval to retain Empire beyond December 31, 1980. There is no assurance that the Federal Reserve Board will determine that Baldwin's ownership of Empire meets the statutory tests permitting its retention by Baldwin on an indefinite basis. However, the question whether operation of a savings and loan association will be determined to be a Permitted Activity for Baldwin was partially decided by a decision made by the Federal Reserve Board in 1974. In that decision, the Board concluded that operation of a savings and loan association met the statutory requirement that such activity be "closely related to banking". The question as to whether such activity is "so closely related to banking as to be a proper incident thereto," which requires satisfaction of certain public interest tests before Board approval may be given, remains unanswered. The Company's application seeks the determination that continuing ownership of Empire will be in the public interest.

With respect to its investment in NFU, the Company must determine whether by December 31, 1980 it (i) will change the form of its investment in such company, probably to a debt instrument, in which event, the contribution of NFU to net income of the Company would consist of interest received or accrued during the year, (ii) will divest, either by distribution to the Company's shareholders or by sale to an unrelated third party, its present investment in NFU, or (iii) will cease to be a bank holding company, either by distribution to the Company's shareholders or by sale to an unrelated third party, of its present investment in the banks.

The Company has sold installment receivable contracts to financial institutions. At December 31, 1975, the total unpaid contract balance of receivables sold amount to $17,097,500 ($31,582,200 at December 31, 1974). Under the terms of certain of the sales agreements, the Company is obligated to repurchase delinquent accounts up to an amount withheld by the purchasers ($2,004,500 at December 31, 1975 and $3,511,600 at December 31, 1974). Under other agreements covering accounts sold having an aggregate unpaid balance of $3,464,000 at December 31, 1975 ($6,262,100 at December 31, 1974), the Company must substitute current accounts for any account becoming delinquent. Management is of the opinion that adequate provision has been made in the financial statements for losses arising from the reacquisition of such paper.

The Company and certain of its subsidiaries are involved in various lawsuits arising in the normal course of business, none of which is expected to result in any material loss to the Company.

The Company and its consolidated subsidiaries are obligated under noncancellable leases for real and personal property. The renewal periods do not exceed ten years at rentals which are approximately equal to the original terms. Rent expense for the years ended December 31, 1975 and 1974 amounts to approximately $1,446,000 and $1,152,300, respectively (substantially all of which are related to non-capitalized financing leases). Minimum rental payments on non-capitalized financing leases amount to approximately $1,638,000, $1,838,000, $1,804,000, $1,769,000 and $1,741,000 for each of the five years ended December 31, 1980 and $5,925,000, $5,053,000 and $4,960,000 for each of the three five year periods beginning January 1, 1981 and $9,675,000 thereafter. Capitalization of financing leases would not have a material effect on net income or stockholders' equity.

9) Commitments and Contingent Liabilities (continued)

In the normal course of business, there are outstanding various commitments and contingent liabilities such as letters of credit (amounting to approximately $5,994,000 at December 31, 1975), guarantees, commitments to extend credit, etc. No material losses are anticipated as a result of these transactions.

The amount of dividends which Empire may pay to the Company is restricted by supervisory authorities. Approximately $2,200,000 of the retained earnings of Empire was available for the payment of dividends at December 31, 1975. Under provisions of a term loan agreement, retained earnings of Baldwin Piano & Organ Company were not available for dividends; however, 50% of future earnings are available for dividends.

10) Acquisitions

In January, 1974, the Company purchased North Denver Bank. In April, 1974, the Company purchased four additional banks (First National Bank in Grand Junction, First National Bank in Glenwood Springs, First National Bank in Aspen and First National Bank — North in Grand Junction, all of Colorado). In May, 1974, the Company purchased Central Colorado Bancorp, Inc., a bank holding company which owned four banks (Central Colorado Bank, Academy Boulevard Bank, Rocky Ford National Bank, and State Bank of Greeley, all of Colorado). In these transactions, the total purchase price of $16,754,186 ($504,230 in cash and $16,249,956 paid by the issuance of 193,450 Class C preferred shares) plus deferred bank acquisition costs of $616,539 exceeded the fair value of the net assets acquired by $8,292,490 which is included (less amortization) in excess of cost of consolidated subsidiaries over the Company's share of the fair value of net underlying assets at dates of acquisition in the consolidated balance sheet.

In November, 1974, the Company acquired the C. C. Fletcher Mortgage Company (a mortgage banking company located in Cincinnati, Ohio, servicing approximately $32 million of mortgages) for 30,188 common shares. In addition, contingent future payments in common shares not to exceed $191,000 may be made.

The acquisitions in 1974 have been accounted for as purchases, and accordingly, the results of operations of such companies have been included in the consolidated statements of income only for the periods from dates of purchase to December 31, 1975.

The following pro forma information has been prepared assuming that these acquisitions were made on January 1, 1974, and assuming non-conversion of the Class C shares through the actual dates of acquisition:

	December 31, 1974
Banking and other related financial services:	
Operating income	$64,165,071
Income from banking and other related financial services	$ 6,601,695
Net income	$11,974,117
Primary income per common share:	
Before cumulative effect of a change in accounting principle	$1.66
Net income	$1.92
Fully diluted income per common share:	
Before cumulative effect of a change in accounting principle	$1.50
Net income	$1.70

In January, 1975, the Company purchased the Peoples Bank of Arapahoe County, Colorado, with assets of approximately $12,000,000, for approximately $175,000 in cash and issuance of a 9% note of $1,049,947 due in 15 years. Also in 1975, the Company formed a new bank in Colorado, The First National Bank in Craig.

ACCOUNTANTS' REPORT

The Board of Directors and Stockholders
D. H. Baldwin Company:

We have examined the consolidated balance sheets of D. H. Baldwin Company and Consolidated Subsidiaries as of December 31, 1975 and 1974 and the related consolidated statements of income, stockholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the consolidated financial statements of National Farmers Union Service Corporation (an unconsolidated subsidiary) and its subsidiaries. The company's investment in National Farmers Union Service Corporation was $27,833,489 at December 31, 1975 and $28,464,838 at December 31, 1974, and its equity in the earnings of National Farmers Union Service Corporation was $2,207,204 and $3,196,987 for the years 1975 and 1974, respectively. These statements were examined by other auditors whose reports thereon have been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for National Farmers Union Service Corporation and subsidiaries, is based solely upon the report of other auditors.

In our opinion, based upon our examination and the reports of other auditors, the aforementioned consolidated financial statements present fairly the financial position of D. H. Baldwin Company and Consolidated Subsidiaries at December 31, 1975 and 1974, and the results of their operations, and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles which, except for the changes, with which we concur, in the method of valuing inventories of an unconsolidated subsidiary in 1974 and valuing non-current marketable equity securities in 1975, as described in notes 2 and 1B, respectively, to the consolidated financial statements, have been applied on a consistent basis.

PEAT, MARWICK, MITCHELL & CO.

Cincinnati, Ohio
February 2, 1976

D. H. Baldwin Company and Consolidated Subsidiaries

Quarterly Performance — Lines of Business

(in thousands of dollars — except per share data)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1975 Quarterly Performance					
Revenues:					
Financial services:					
Banking and other related financial services	$16,050	15,350	15,657	16,144	63,201
Savings and loan services	8,091	8,640	12,515	9,171	38,417
Insurance services	13,762	13,742	15,259	15,087	57,850
Total financial services	37,903	37,732	43,431	40,402	159,468
Musical instrument operations	18,375	16,125	17,126	25,640	77,266
Combined revenues	$56,278	53,857	60,557	66,042	236,734
Income before holding company expenses:					
Financial services:					
Banking and other related financial services	$ 1,686	1,780	1,563	1,427	6,456
Savings and loan services	875	1,077	1,109	1,051	4,112
Insurance services	820	534	627	226	2,207
Total financial services	3,381	3,391	3,299	2,704	12,775
Musical instrument operations	564	517	500	1,831	3,412
Unallocated holding company interest and administrative expenses, net of income tax credit	1,114	1,016	1,212	1,344	4,686
Net income	$ 2,831	2,892	2,587	3,191	11,501
Primary income per common share	$ .44	.44	.39	.48	1.75
Fully diluted income per common share	$ .38	.38	.35	.43	1.54
Dividends per common share	$ .10	.12	.15	.15	.52
Market price of common share	$ 6–9	7–11	8–12	8–10	6–12
1974 Quarterly Performance					
Revenues:					
Financial services:					
Banking and other related financial services	$10,879	13,459	16,044	17,072	57,454
Savings and loan services	6,951	7,376	7,343	7,587	29,257
Insurance services	11,399	12,570	12,724	13,173	49,866
Total financial services	29,229	33,405	36,111	37,832	136,577
Musical instrument and other operations	16,590	17,430	16,869	23,150	74,039
Combined revenues	$45,819	50,835	52,980	60,982	210,616
Income before holding company expenses:					
Financial services:					
Banking and other related financial services	$ 845	1,335	1,700	1,763	5,643
Savings and loan services	1,046	1,148	751	710	3,655
Insurance services	859	713	777	848	3,197
Total financial services	2,750	3,196	3,228	3,321	12,495
Musical instrument and other operations before cumulative effect of a change in accounting principle*	315	273	42	647	1,277
Unallocated holding company interest and administrative expenses, net of income tax credit	652	1,192	1,134	1,155	4,133
Income before cumulative effect of a change in accounting principle	2,413	2,277	2,136	2,813	9,639
Cumulative effect of a change in accounting principle	1,377	—	—	—	1,377
Net income*	$ 3,790	2,277	2,136	2,813	11,016
Primary income per common share:*					
Before cumulative effect of a change in accounting principle	$ .41	.39	.32	.44	1.56
Net income	$ .67	.39	.32	.44	1.82
Fully diluted income per common share:*					
Before cumulative effect of a change in accounting principle	$ .39	.32	.28	.37	1.36
Net income	$ .60	.32	.28	.37	1.57
Dividends per common share	$ .10	.10	.10	.15	.45
Market price of common share	$ 12–14	9–12	6–10	5–7	5–14

*The quarterly results for 1974 have been restated to reflect the cumulative effect of a change in accounting principle. LIFO was also adopted in 1974. These changes are related to the musical instrument operations and are explained in note 2 to the financial statements.

D. H. Baldwin Company and Consolidated Subsidiaries

Management's Discussion and Analysis of Consolidated Summary of Income

(in thousands of dollars except per share amounts)

	Year Ended	
	1971	**1972**
Banking and other related financial services:		
Revenues	$25,158	$28,612
Expenses:		
Operating expenses	11,524	13,012
Interest	8,200	8,591
Federal and state income taxes	1,963	2,008
	21,687	23,611
Income from banking and other related financial services	3,471	5,001
Savings and loan services:		
Revenues	20,216	24,328
Expenses:		
Operating expenses	4,477	4,079
Interest	11,431	13,728
Federal and state income taxes	864	1,602
	16,772	19,409
Income from savings and loan services	3,444	4,919
Equity increase (decrease) in unconsolidated subsidiaries:		
Insurance services	2,092	2,525
Musical instrument operations before cumulative effect of a change	1,348	1,320
Electronics	(153)	(481)
	3,287	3,364
Unallocated holding company expenses:		
Interest	4,526	4,940
Administrative	1,502	1,748
Total	6,028	6,688
Federal income tax credit on unallocated expenses	2,873	3,210
	3,155	3,478
Income before cumulative effect of a change in accounting principle	7,047	9,806
Cumulative effect of a change in accounting principle	—	—
Net income [1]	7,047	9,806
Less dividends on preferred shares	925	910
Net income applicable to common shareholders	$ 6,122	$ 8,896
Primary income per common share:		
Income before cumulative effect of a change in accounting principle	$1.20	$1.72
Cumulative effect of a change in accounting principle	—	—
Net income	$1.20	$1.72
Fully diluted income per share:		
Income before cumulative effect of a change in accounting principle	$1.13	$1.59
Cumulative effect of a change in accounting principle	—	—
Net income	$1.13	$1.59

[1] Net income in 1974 includes the cumulative effect of a change in accounting principle. LIFO was also adopted in 1974 and as a result net income and primary income per share were reduced by $1,348,000 and $.26 respectively. These changes are related to the musical instrument operations and are explained in note 2 to the financial statements.

December 31,			Amount of Increase (Decrease)	
1973	**1974**	**1975**	**Year 1974 Over 1973**	**Year 1975 Over 1974**
$36,466	$57,453	**$63,201**	$20,987	$ 5,748
14,874	23,034	**29,981**	8,160	6,947
16,274	26,352	**23,693**	10,078	(2,659)
1,394	2,424	**3,071**	1,030	647
32,542	51,810	**56,745**	19,268	4,935
3,924	5,643	**6,456**	1,719	813
28,805	29,257	**38,417**	452	9,160
5,694	4,815	**9,553**	(879)	4,738
16,144	19,625	**23,382**	3,481	3,757
1,831	1,162	**1,370**	(669)	208
23,669	25,602	**34,305**	1,933	8,703
5,136	3,655	**4,112**	(1,481)	457
3,435	3,197	**2,207**	(238)	(990)
1,972	1,183	**3,412**	(789)	2,229
(46)	93	**—**	139	(93)
5,361	4,473	**5,619**	(888)	1,146
4,018	5,748	**6,089**	1,730	341
1,837	2,483	**3,130**	646	647
5,855	8,231	**9,219**	2,376	988
2,810	4,099	**4,533**	1,289	434
3,045	4,132	**4,686**	1,087	554
11,376	9,639	**11,501**	(1,737)	1,862
—	1,377	**—**	1,377	(1,377)
11,376	11,016	**11,501**	(360)	485
888	1,350	**1,891**	462	541
$10,488	$ 9,666	**$ 9,610**	$ (822)	$ (56)
$2.00	$1.56	**$1.75**		
—	.26[1]	**—**		
$2.00	$1.82	**$1.75**		
$1.85	$1.36	**$1.54**		
—	.21[1]	**—**		
$1.85	$1.57	**$1.54**		

In 1975 the Company's income from banking and other related financial services, savings and loan services and musical instrument operations increased over 1974, while income from insurance services decreased. Unallocated holding company expenses increased during the same period. In 1974, income from banking services increased over 1973; however, the Company realized lower earnings from its other lines of business and higher holding company expenses in 1974 as compared to 1973.

Banking and Other Related Financial Services
Income from banking and other related financial services increased $813,000 in 1975 as compared to 1974 due primarily to a more favorable spread between the interest rate earned on earning assets and the cost of the interest rate expensed on deposits and borrowed funds.

Revenues, operating expenses and income from banking and other related financial services increased in both 1974 and 1975 over the previous years. These increases are due primarily to the Company's acquisition of nine banks in January, April and May, 1974. As a result of these acquisitions, the Company's average balance of assets employed in banking services increased from $404 million in 1973 to $659 million in 1974, an increase of 63%. In 1975, this average balance of assets increased 2% to $671 million.

The following table reflects the average interest rate earned (on a tax equivalent basis), the average interest rate expensed and the net interest spread for the three years ended December 31, 1975 for banking and other related financial services:

	Year Ended December 31,		
	1973	1974	1975
Rate earned	9.30%	9.45%	9.87%
Rate expensed	6.72%	6.83%	6.02%
Net interest spread . .	2.58%	2.62%	3.85%

Banking and Other Related Financial Services (continued)

The increase in banking revenues in 1974 as compared to 1973 was due to a higher average rate earned on a larger average volume of earning assets, whereas the revenue increase in 1975 as compared to 1974 was due to a higher average rate earned on a comparable average volume of earning assets. Interest expense increased in 1974 over 1973 due to a higher average rate expensed on larger average deposits and borrowings, whereas the decrease in interest expense in 1975 as compared to 1974 resulted from a lower average rate applied to a comparable average volume of deposits and borrowings.

Operating expenses increased $8,160,000 in 1974 and $6,947,000 in 1975 over the previous years. A substantial portion of these increases was due to the inclusion of the acquired banks for seven months in 1974 and the entire year in 1975. In addition to the effect of these acquisitions, salaries and employee benefits increased as a result of normal merit and length of service adjustments. Higher occupancy costs (due to the expansion of banking facilities), utility costs, real estate taxes, computer facilities and system expense (due to expansion and improvement) and the inflationary effects on postage, supplies and maintenance costs all contributed to increased operating expenses in 1974 and 1975.

A summary of the changes in the allowance for loan losses is presented in note 4 of Notes to Consolidated Financial Statements of D. H. Baldwin Company and Consolidated Subsidiaries. The provisions for loan losses is composed of a minimum amount based on a historical five year moving average of net loan losses to outstanding loans or in the case of other related financial services and newly organized banks an amount based on a percentage of new business. In addition, the provision is adjusted for other factors, which in management's judgment, deserve recognition in estimating possible loan losses. The provision for loan losses in 1973 and 1974 was based on the average volume of loans and the five year moving average. The provision for 1975 included an additional provision of $845,000 over the minimum amount. Management's decision as to the need for this additional provision was based upon its analysis of overall economic factors and the following other factors specifically related to its loans: (1) Baldwin's historical experience as to charge-offs and recoveries as compared to the level of the allowance, (2) continuing Management review of individual loans and the overall risk characteristics of the loan portfolio, (3) consideration of examinations and evaluations of the loan portfolio by federal and state regulatory authorities and independent reviews and evaluations of loans by the Directors' Examining Committee and the Company's internal audit staff. In the judgement of Management, the Company's $5,188,314 allowance for loan losses at December 31, 1975 is adequate in that there is no anticipated exposure to loan losses in excess of this amount.

Savings and Loan Services

Since 1971, revenues from loans have shown increases which reflected the growth in the loan portfolio as well as an increasing average yield earned thereon. During this period, increased operating expenses were attributable to the establishment of additional branch office locations as well as a generalized rise in costs of services. The percent of general and administrative expenses to interest and fees on loans and investments remained stable throughout this period.

Revenues and operating expenses for 1975 reflect the sale price and cost of developed real estate sold of $3,402,500 and $3,567,761, respectively, in that year. Loan fees of $167,500 were received on this sale of developed real estate. There were no sales of developed real estate in 1974.

In 1975 savings account deposits increased $63 million to $329 million and borrowings from the Federal Home Loan Bank were reduced by $10 million; however, average borrowings in 1975 were higher than in 1974.

Savings and loan services had no net loan losses in 1973, 1974 nor 1975.

Income from savings and loan services increased $457,000 in 1975 as compared to 1974 due to an increased interest margin on a larger volume of earning assets.

Insurance Services

During the past three years revenues from insurance services have increased each year as is illustrated by the following table:

	Years Ended December 31,		
	1973	1974	1975
		(in millions)	
Life and health premiums	$12.8	$14.5	$17.2
Property and casualty premiums	$26.1	$30.7	$35.1
Investment income, net	$ 3.7	$ 4.7	$ 5.4

Insurance Services (continued)

During this period the benefits paid and expenses associated with life and health insurance have increased proportionately. Income from life and health insurances before realized investment gains has not changed significantly throughout this period; 1973 — $2.0 million, 1974 — $2.0 million and 1975 — $1.9 million.

In both 1974 and 1975 casualty losses and underwriting expenses increased in the property and casualty companies. These increased casualty losses and underwriting expenses resulted in lower earnings from the property and casualty companies; 1973 — $2.2 million, 1974 — $2.1 million and 1975 — $.6 million.

Net realized investment gains were not material in either 1974 or 1975. Net unrealized depreciation of marketable equity securities aggregated $2.3 million at December 31, 1975. Net unrealized depreciation in 1974 amounted to approximately $2.8 million and net unrealized appreciation in 1975 amounted to approximately $1.6 million.

Musical Instrument Operations

Both dollar and unit sales of musical instrument operations have increased in each year since 1971. The percentage increases in sales dollars from 1971 on a year to year basis as compared to the prior year are 24.0%, 12.3%, 11.7% and 4.5%. These increases in sales dollars during 1974 and 1975 resulted both from price increases (due to increased costs) and improved unit sales.

Income from musical instrument operations increased $2,229,000 in 1975 as compared to 1974 and decreased $789,000 in 1974 as compared to 1973. The most significant factors which produced these results are illustrated in the following table:

	Years Ended December 31,		
	1973	1974	1975
Net sales	$65.8	$73.5	$76.8
Cost of goods sold	48.7	56.9	53.5
Gross profit on sales	$17.1	$16.6	$23.3
Gross profit %	26%	23%	30%

The decrease in gross profit in 1974 was due primarily to the adoption of LIFO in 1974. In 1975 the musical instrument operations achieved a significant improvement over 1974 in its gross profit percent. The addition of new machinery and equipment, on premise warehouse facilities and a better inventory control system all added to improved operating efficiencies.

Electronic Operations

In 1974 the Company sold or leased substantially all the assets and liabilities of its former wholly-owned subsidiary, Baldwin Electronics, Inc. and transferred its investment in Siliconix incorporated to National Farmers Union Service Corporation as a contribution to the capital of that company. In 1975 the Company discontinued the practice of reporting its limited activity in the field of electronics as a separate line of business.

Unallocated Holding Company Expenses

Interest expense for 1975 and 1974 increased over the prior years due to a higher average rate of interest paid on increased borrowings.

In 1975 the Company classified $428,000 of costs associated with the Company's limited electronic activities as administrative expenses since this activity is no longer reported as a separate line of business. The additional increase in administrative expenses of $219,000 was attributable to increased legal, accounting and auditing expenses and higher salaries and employee benefits which reflected normal merit and length of service adjustments.

The increase in administrative expenses for 1974 as compared to 1973 reflects the expansion of the Company's operations and the related costs. The principal items which accounted for these increases were legal, accounting and auditing expenses, expenses related to the filing of reports with various governmental regulatory bodies and higher salaries which reflected normal merit and length of service adjustments.

Cumulative Effect of a Change in Accounting Principle

In 1974 the musical instrument operations changed its method of allocation of overhead to work-in-process inventories. The cumulative effect of this change in an accounting principle, aggregating $1,377,000 (net of income taxes), results from the application of the change in method of allocation of overhead to prior years' inventories.

Dividends on Preferred Shares

The increase in preferred dividends for both 1975 and 1974 as compared to prior years was due primarily to dividends paid on preferred shares issued in connection with the acquisition of eight of the banks acquired in 1974.

D. H. Baldwin Company

10 Year Summary of Common Share Activity

Years Ended December 31 — (000) omitted for number of shares only

Year	Shares Outstanding January 1	Stock Dividends	Stock Splits	Additional Shares Issued	Treasury Share Activity	Shares Outstanding December 31	Market Price	Price Earnings Ratio	Dividends Paid	Average Yield	Number of Shareholders
1966	1,118	—	—	12	(10)	1,120	$ 5-8	9-12	$.24	3.7%	997
1967	1,120	—	—	9	8	1,137	5-9	12-20	.27	3.9	1,301
1968	1,137	—	—	23	—	1,160	6-13	8-17	.27	2.8	1,450
1969	1,160	—	—	7	(1)	1,166	10-14	10-15	.28	2.4	1,631
1970	1,166	—	—	10	(3)	1,173	5-12	6-14	.28	3.4	1,752
1971	1,173	94	1,173	14	(2)	2,452	7-14	6-11	.28	2.8	1,844
1972	2,452	100	—	69	(1)	2,620	11-21	7-12	.29	1.9	2,123
1973	2,620	—	2,620	61	(41)	5,260	11-21	6-11	.34	2.1	2,730
1974	5,260	—	—	70	38	5,368	5-14	3-8	.45	4.6	3,307
1975	5,368	—	—	384	(8)	5,744	6-12	4-7	.52	5.8	3,533

NOTES:

1966 — September, admitted to American Stock Exchange. Issued 11,800 shares under employee stock option plan. Purchased (net of sales) 9,669 shares for the treasury.

1967 — July, reissued 10,000 treasury shares pursuant to the purchase of The Fred Gretsch Manufacturing Company. Issued 9,392 shares under employee stock option/stock purchase plans. Reissued 1,415 treasury shares upon conversion of preferred shares. Purchased (net of sales) 3,604 shares for the treasury.

1968 — Issued 7,660 shares under employee stock option/stock purchase plans. Issued 14,706 shares to the Baldwin Profit Sharing Trust. Reissued 1,530 treasury shares upon conversion of preferred shares. Sold (net of purchases) 1,512 treasury shares.

1969 — Issued 6,999 shares under employee stock option/stock purchase plans. Purchased (net of sales) 546 shares for the treasury.

1970 — Issued 9,795 shares under employee stock option/stock purchase plans. Purchased (net of sales) 2,779 shares for the treasury.

1971 — January, paid 4% stock dividend. June, converted 1,173,481 shares, no par value, $4.00 stated value to 2,346,962 shares, no par value, $2.00 stated value. Issued 10,385 shares under employee stock option/stock purchase plans. Issued 3,467 shares upon conversion of preferred shares. Purchased (net of sales) 3,052 shares for the treasury.

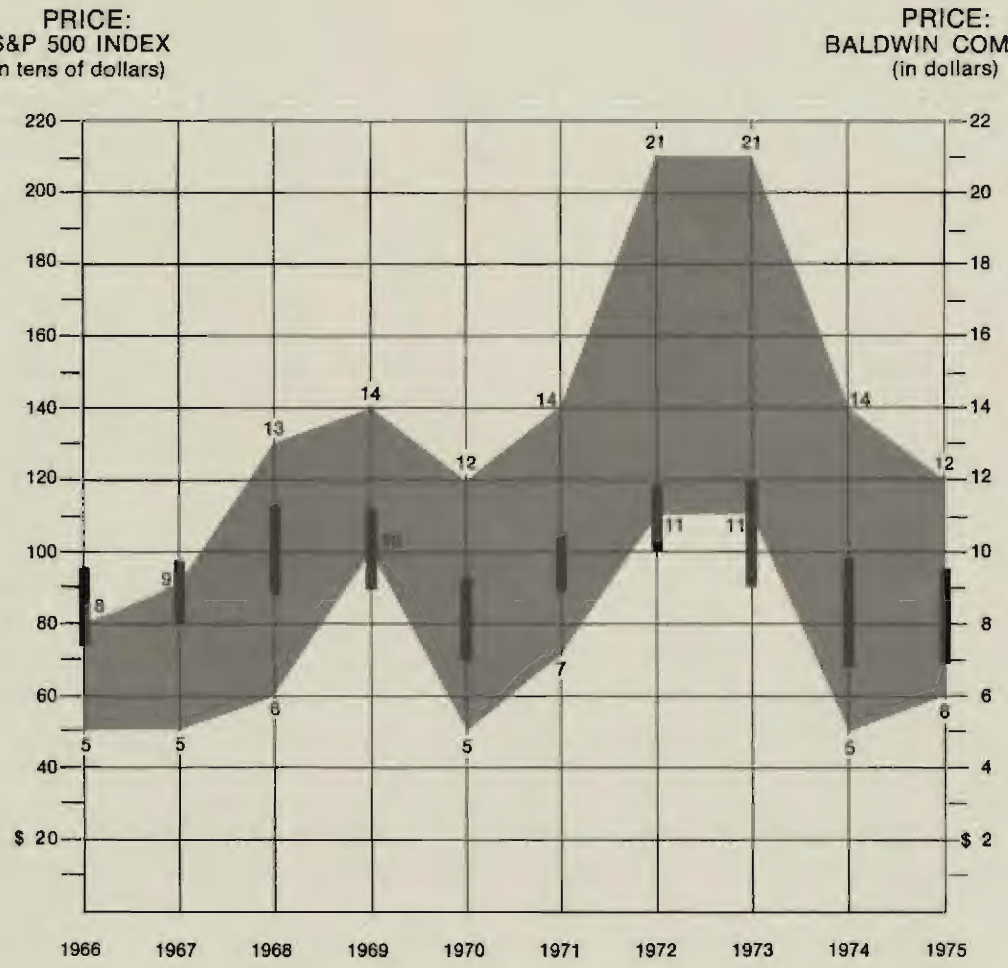
1972 — January, paid 4% stock dividend. Issued 44,899 shares under employee stock option/stock purchase plans. Issued 24,307 shares upon conversion of preferred shares. Purchased (net of sales) 759 shares for the treasury.

1973 — April, converted 2,620,337 shares, no par value, $2.00 stated value to 5,240,674 shares, no par value, $1.00 stated value. July, admitted to New York Stock Exchange. Issued 53,545 shares under employee stock option/stock purchase plans. Issued 7,597 shares upon conversion of preferred shares. Purchased (net of sales) 42,140 shares for the treasury.

1974 — November, issued 30,188 shares pursuant to purchase of C. C. Fletcher Mortgage Company. Issued 19,088 shares under employee stock option/stock purchase plans. Issued 20,731 shares upon conversion of preferred shares. Sold (net of purchases) 38,335 treasury shares.

1975 — Issued 29,222 shares under employee stock option/stock purchase plans. Issued 354,851 shares upon conversion of preferred shares. Purchased (net of sales) 8,417 shares for the treasury.

COMPARISON OF RELATIVE PRICE CHANGE IN BALDWIN COMMON STOCK AND STANDARD & POOR'S COMPOSITE INDEX



. . . Baldwin Ten Year Trading Range
(Annual high & low based on daily closing prices)

. . . Standard & Poor's Composite — 500 Stock Index Ten Year Trading Range
(Annual high & low based on daily index)

Loveland Pass, Colorado

Transfer Agents
Common Shares:
Central Bank of Denver
Manufacturers Hanover Trust Company, New York
D. H. Baldwin Company
Preferred Shares — All Series:
Central Bank of Denver
D. H. Baldwin Company

Registrars
Common Shares:
The Fifth Third Bank, Cincinnati
First National City Bank, New York
United Bank of Denver
Preferred Shares — All Series:
Central Bank of Denver
D. H. Baldwin Company

Trustees
1975 Series A & B Debentures:
First National Bank of Chicago
1975 Series A & B Capital Notes &
1976 Series A & B Capital Notes:
St. Louis Union Trust Company

Legal Counsel
Kyte, Conlan, Wulsin, and Vogeler
Cincinnati

Accountants
Peat, Marwick, Mitchell & Co.
Cincinnati

Stock Listed
New York Stock Exchange (BDW)
Cincinnati Stock Exchange

D. H. Baldwin Company and Subsidiaries • General Offices: 1801 Gilbert Avenue, Cincinnati, Ohio 45202 • Area Code 513/852-7000



D. H. Baldwin Company 1801 Gilbert Avenue Cincinnati, Ohio 45202